Supreme Court, U.S.
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IN THE

Supreme Court of the United States

GRAND RIVER ENTERPRISES SIX NATIONS, LTD.,

Petitioner,

v.

MIKE BEEBE, in his official capacity as Attorney General, State of Arkansas,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. In 2002, Petitioner, Grand River Enterprises Six Nations, Ltd. ("Grand River"), commenced a lawsuit against the Attorneys General of thirty-one (31) States in federal district court in New York, challenging model legislation adopted by their respective States to implement the Tobacco Master Settlement Agreement ("MSA"). The Second Circuit Court of Appeals has twice held that Petitioner's antitrust and Commerce Clause challenges to the model legislation state a claim for relief under Fed. R. Civ. P. 12(b)(6). Although the State of Arkansas adopted the same model legislation, the Arkansas Attorney General was not included in that lawsuit, because, at that time, the State of Arkansas had not enforced, nor threatened enforcement of, the model legislation against Petitioner. In this later-filed action against the Arkansas Attorney General, the Court of Appeals for the Eighth Circuit, with one Judge dissenting, has held that challenges to the model legislation in Arkansas — challenges identical to those permitted by the Second Circuit — fail to state a claim. As such, the question presented is whether, despite the decisions of the Second Circuit holding and acknowledging that Petitioner has stated a claim pursuant to Fed. R. Civ. P. 12(b)(6) that model legislation enacted by thirty-one (31) States to implement the MSA violates the Sherman Act, the Eighth Circuit erred in affirming dismissal of Petitioner's Sherman Act challenge to the same model legislation enacted by the State of Arkansas, pursuant to Fed. R. Civ. P. 12(b)(6).

2. Whether, despite the decisions of the Second Circuit holding and acknowledging that Petitioner has stated a claim pursuant to Fed. R. Civ. P. 12(b)(6) that model

legislation enacted by thirty-one (31) States to implement the MSA violates the Commerce Clause, the Eighth Circuit erred in affirming dismissal pursuant to Fed. R. Civ. P. 12(b)(6) of Petitioner's Commerce Clause challenge to the same model legislation enacted by the State of Arkansas.

3. Whether the Eighth Circuit erred in ruling that the Petitioner has not pled a *prima facie* claim for violation of the Equal Protection Clause of the Fourteenth Amendment, as it alleges that the Arkansas legislation requires Petitioner to undertake the payment obligations of an MSA class of tobacco manufacturers, but does not extend to Petitioner certain benefits that inure to that same class pursuant to the terms of the MSA.

4. Whether the Eighth Circuit erred in ruling that the Petitioner has not pled a *prima facie* claim with respect to the Arkansas legislation violating substantive and procedural due process by requiring Petitioner to enter into a settlement with forty-five (45) other States and fund an escrow account for Arkansas' benefit based on Petitioner's share of the national cigarette market, and by not providing for a hearing prior to Petitioner being required to make deposits into the escrow account, with said deposits being held for twenty-five years.

5. Whether the Eighth Circuit erred in ruling the Petitioner has not pled a *prima facie* claim with respect to the Arkansas legislation violating the First Amendment by granting financial concessions and exemptions only to certain manufacturers that joined the MSA and agreed to restrict their freedoms of speech, petitioning, and association pursuant to the terms of the MSA.

LIST OF PARTIES

Southwestern Trading Co., Inc. and The Ritchie Grocer Co. were dismissed by the district court and Heber Springs Wholesale Grocery, Inc. was dismissed by the court of appeals.

CORPORATE DISCLOSURE STATEMENT

Petitioner, Grand River Enterprises Six Nations, Ltd., does not have any parent corporation and no publicly held corporation owns ten percent (10%) or more of its stock.

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OPINION BELOW

The majority and dissenting opinions of the United States Court of Appeals for the Eighth Circuit are reported at *Grand River Enterprises Six Nations, Ltd. v Beebe*, 574 F.3d 929 (8th Cir. 2009) ("*Grand River II*"). That court subsequently entered an order denying Grand River's petition for a rehearing and rehearing *en banc*. The Eighth Circuit, with one judge dissenting, affirmed the decision of the United States District Court for the Western District of Arkansas, Fayetteville Division, reported at 418 F.Supp. 1082 (W.D. Ark. 2006). *See* Appendices A-C.

STATEMENT OF JURISDICTION

This Court's jurisdiction is invoked under 28 U.S.C. § 1254(1).

The Eighth Circuit's Opinion was rendered on August 4, 2009, with the order denying the petition for rehearing and rehearing *en banc* being dated, and entered on, October 1, 2009.

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

Title 15 United States Code, Section 1

Sherman Anti-Trust Act

> Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several states, or with foreign nations, is hereby declared to be illegal.

United States Constitution, Article 1, Section 9, Clause 3

The Congress shall have Power to regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes.

United States Constitution, Fourteenth Amendment, Section 1

All persons born or naturalized in the United States and subject to the jurisdiction thereof, are citizens of the United States and of the State wherein they reside. No State shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States; nor shall any State deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws.

United States Constitution, First Amendment

Congress shall make no law respecting an establishment of religion, or prohibiting the free exercise thereof; or abridging the freedom of speech, or of the press; or the right of the people peaceably to assemble, and to petition the Government for a redress of grievances.

Ark. Code Ann. § 26-57-261

See Appendix D.

STATEMENT OF THE CASE

1. *The MSA*

In November 1998, forty-six States ("MSA States") and five U.S. Territories entered into the MSA with the nation's four largest cigarette manufacturers (Original Participating Manufacturers or "OPMs").[1] The MSA settled more than forty lawsuits arising out of the OPMs' alleged fraudulent, deceitful and anticompetitive conduct. The MSA provides for the OPMs to make settlement payments to the MSA States in the aggregate amount of $206 billion over a 25 year period, and $9 billion annually thereafter. The OPMs agreed to share the cost of the settlement payments amongst themselves, based on their aggregate sales volume and respective shares of the United States market. The purpose and effect of this agreement, according to Petitioner, was and is to tie the cost and resulting pricing decisions of each OPM to the national output of the group as a whole, as well as their relative output vis-à-vis other members of the group. The OPMs also agreed permanently to cease outdoor advertising, sponsorship of certain public events, specified brand name and product promotions, lobbying for, or support of, any legislation that would abrogate MSA States' rights under the MSA, and associating through trade groups, except to the extent permitted by the MSA.

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1. The OPMs are Philip Morris, Inc., R.J. Reynolds Tobacco Company, Brown & Williamson Tobacco Corp., and Lorillard Tobacco Company.

The MSA payments are divided among the MSA States pursuant to percentages set forth in an exhibit to the MSA, which delineates each state's percentage of the payments. Each MSA State's share of the payments is commonly referred to as its "allocable share."

The OPMs refused to enter into the MSA unless the MSA payment requirements were also imposed on all other manufacturers whose cigarettes are sold in the United States. The OPMs contended that such a payment obligation was required because once they raised their prices to fund the settlement, they anticipated losing market share to manufacturers that were not subject to the MSA's payment requirements and marketing restrictions. As such, the MSA was drafted to apply to all manufacturers whose cigarettes are sold in the United States, without regard to whether a manufacturer has ever been sued for, or accused of, the conduct that give rise to the claims against the OPMs that were released by the MSA.[2]

Specifically, the MSA provides that manufacturers that are not original parties to the MSA may join the MSA as a Subsequent Participating Manufacturer ("SPM"). SPMs that joined the MSA within 90 days of its execution date ("Exempt SPMs") are exempted from making any MSA payments based on the greater of

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2. No state has ever filed an action against Grand River alleging that cigarette smoking has caused the state to expend public funds on health care costs (which is the gravaman of the MSA States' actions against the OPMs) and seeking recovery of those costs.

(1) their 1998 market share or (2) 125% of their 1997 market share. A manufacturer that becomes a SPM after the 90-day deadline is not afforded any exemption and must make MSA payments on each and every cigarette it sells.

The MSA contemplates that not all manufacturers will join the MSA, and addresses their non-participation through model legislation that is an exhibit to the MSA and defined as a "Qualifying Statute." The MSA defines a Qualifying Statute as legislation "that effectively and fully neutralizes the cost disadvantages that [OPMs and SPMs] experience vis-à-vis Non-Participating Manufacturers within [the MSA] State[s] as a result of the provisions of th[e MSA]." In essence, the Qualifying Statute requires a manufacturer that is not a party to the MSA (a Non Participating Manufacturer or "NPM") to either: (1) join the MSA as a party (*i.e.*, as an SPM) and make the payments required of an SPM, or (2) remain a NPM and maintain an escrow bank account in every state in which the NPM's cigarettes are sold, into which annual payments must be made and held for the MSA State's benefit. Each annual escrow deposit is held in escrow for 25 years, and then returned to the manufacturer, unless the funds are used to satisfy a judgment or settlement against the manufacturer in a litigation brought by the state.

The MSA penalizes an MSA State that fails to enact and enforce a Qualifying Statute if, and based on the extent to which, the OPMs lose national market share. The MSA accomplishes this penalty, by providing for the loss of up to 100% of the MSA payments the State would otherwise receive (notably, even if the OPMs do

not lose market share in that MSA State). By 2001, every MSA State had enacted a Qualifying Statute ("Escrow Statutes") identical to the one in the MSA. Arkansas' statute is codified at Ark. Code Ann. § 26-57-260 *et seq.* (the "Arkansas Statute").

Under the original, model form of the Arkansas Statute (and all of the Escrow Statutes), an NPM was entitled to an immediate release of escrowed funds that exceeded the amount that the MSA State would have received from that manufacturer under the MSA as an SPM.[3] *See, e.g.*, Ark Code Ann. § 26-57-261; N.Y. Pub. Health Law § 1399-pp. Accordingly, the maximum amount that an NPM was required to hold in escrow for the benefit of Arkansas due to sales in that state in any given year could not exceed the amount the State would have received from the NPM had the NPM joined the MSA – Arkansas' "allocable share."

Significantly, the Arkansas Statute also imposes escrow payment obligations on NPMs even if retailers and wholesalers independently elect to sell the NPMs'

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3. The specific provision of the Arkansas Statute provided in pertinent part:

> To the extent that [an NPM] establishes that the amount it was required to place into escrow in a particular year was greater than the allocable share for the state of the total payments that such manufacturer would have been required to make in that year under the Master Settlement Agreement . . . had it been an [SPM], the excess shall be released from escrow and revert back to such [NPM].

Ark Code Ann. § 26-57-261.

products in the state, and the NPM had no involvement in the sale and does not transact business in Arkansas. Thus, even if the sale of a NPM's product in Arkansas results from the actions of a third party with which the NPM has no relationship and over which it exercises no control, the sale of cigarettes within the MSA State by those third parties obligates the NPM to make the escrow deposit.

2. *The OPMs Raise Prices and Lose Market Share*

Subsequent to the execution of the MSA and enactment of the Escrow Statutes, the OPMs significantly increased their prices (by approximately 300% of that required to fund their MSA payments), which boosted their revenues to record levels, but caused them to lose approximately 7% of their market share to NPMs.[4]

However, the OPMs' declining market share adversely affected the amount of the MSA payments that the MSA States received under the MSA, as the payments are tied directly to the sales volumes and market shares of OPMs, not their profit or revenue. Hence, when OPMs sold fewer cigarettes at higher prices and lost market share, the MSA States received lower MSA payments.

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4. Prophetically, in advising Congress not to adopt the MSA in its precursor form, the Federal Trade Commission specifically warned that the anticompetitive features and consequences of that agreement would likely lead to collusive or more coordinated pricing behavior among the OPMs, with price increases being passed on to consumers as high as 300% of the settlement's costs.

3. *Amendment of the Escrow Statutes & The Arkansas Amendment*

Due to this loss of revenue, all of the MSA States (save for Missouri) enacted identical amendments to the Escrow Statutes, which are generally referred to as "allocable share amendments". In 2005, the Arkansas General Assembly enacted such an Amendment to the Arkansas Statute, Act 384 of 2005 (the "Arkansas Amendment"). As explained below, the Arkansas Amendment does not simply "neutralize" the cost disadvantages that the OPMs and SPMs supposedly experience as a result of the MSA – it effectively bars competition from the NPMs altogether, as its raises their escrow obligations to such an extent that they cannot compete with the OPMs and SPMs.

As discussed *supra*, under the original Arkansas Statute, Grand River's escrow obligation in any given year could not exceed the amount Arkansas would have received from Grand River had it joined the MSA, *i.e.*, Arkansas' allocable share. This "cap" in Grand River's escrow payments permitted Grand River to reduce its escrow payment burden in Arkansas to a point that allowed Grand River's products to compete with those of the OPMs as well as the SPMs that were given payment exemptions under the MSA.

However, due to enactment of the Arkansas Amendment (and the amendments in other MSA States) Grand River's ultimate escrow liability in Arkansas is now measured by the amount Grand River would have paid as an SPM *to all MSA States* (not just Arkansas), on account of the number of Grand River's cigarettes

sold in Arkansas.[5] Thus, the Amendment incorporates the SPM payment provisions of the MSA (without the state allocable share limitation) and makes them binding on NPMs.

Significantly, SPM payments under the MSA are based on formulas that are tied to the total sales volumes of OPMs and OPM market share. Thus, if OPMs raise their prices, sell fewer cigarettes, and lose market share to SPMs and NPMs that do not similarly raise their prices, the MSA payments of SPMs and "virtual" SPM payments of NPMs (*i.e.*, the minimum escrow payments required under the Amendment) increase, both in the aggregate and on a per carton basis. Further, the increased escrow payments required of NPMs under the Arkansas Amendment provide Exempt SPMs with the power to price their products profitably at a level below Grand River's costs, which the Exempt SPMs have done.

The Arkansas Amendment increased Grand River's escrow obligation to Arkansas by nearly 3,000% (over $3.00 per carton), and its total escrow cost per carton

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5. The relevant language of the Amendment reads:

> To the extent that [an NPM] establishes that the amount it was required to place into escrow on account of units sold in the state in a particular year was greater than the [MSA] payments . . . that the manufacturer would have been required to make on account of such units sold had it been [an SPM], the excess shall be released from escrow and revert back to [NPM].

Ark Code Ann. § 26-57-261.

immediately upon passage of the Arkansas Amendment was approximately $4.10, which is nearly one hundred times greater than the amount Arkansas received for each carton of an OPM's or SPM's cigarettes sold in Arkansas. The Arkansas Amendment forces NPMs, including Grand River, to raise their prices to meet the new, increased escrow burdens and to levels that effectively foreclose them from competing in the Arkansas market against members of the cartel-like MSA scheme.

Grand River had complied fully with the Arkansas Statute in Arkansas until the Arkansas Amendment was enacted, which it then challenged in the District Court.

REASONS FOR GRANTING THE PETITION

As discussed *infra*, there is a direct split between the Eighth Circuit and the Second and Third Circuits with respect to whether the allegations made by Grand River constitute *prima facie* claims for violations of the Sherman Act and Commerce Clause. This issue demands resolution by the Court, as it is not tenable for the *same litigant* to make the *same allegations* in different Circuits, and be permitted to litigate its claims in one Circuit (and to obtain relief if its case is proven) and for its claims to be dismissed pursuant to Rule 12(b)(6) in another Circuit, particularly where the claims involve fundamental issues under the Constitution and the Sherman Act.

Grand River alleges that Arkansas (and the other MSA States) adopted a two-part regulatory system that regulates interstate commerce. First, that system

enlists private parties to enter into an agreement that fixes costs (a component of price) among them, based on complicated formulas that make the cost and price of each party dependent on the output and pricing decisions of all other parties. Second, Arkansas enacted legislation that makes the MSA's financial terms binding on manufacturers who do not wish to be bound by that agreement. As such, this system of restraint is not a unilateral act of Arkansas alone.

Grand River alleges that, as a matter of law, such a system, which, on its face and in its effect, ties the costs and price of one group of competitors to the pricing and output decisions of another group, at the behest of the latter, while granting yet another group the discretionary pricing power to exclude their competitors from the market, is a *per se* or unreasonable restraint of trade. Thus, Grand River contends it has set forth a *prima facie* claim for a violation of the Sherman Act.

With respect to the Commerce Clause, requiring a regulated entity to make payments for the benefit of a State based on the amount the entity would have otherwise paid to all States, under an agreement that has the effect of imposing a *de facto* national tax, constitutes an impermissible, interconnected and interdependent attempt to regulate interstate commerce in violation of the Commerce Clause. Moreover, imposing those payment obligations on a manufacturer that has no nexus with the State but, rather, simply based on the fact that the manufacturer's products are sold in the State by independent third parties remotely situated in the chain of distribution, impermissibly encroaches upon the federal

government's jurisdiction and authority over interstate commerce under the Commerce Clause. As such, Grand River contends it has pleaded a *prima facie* claim for violation of the Commerce Clause.

With respect to the Equal Protection, Due Process and First Amendment claims, Grand River submits that it has alleged *prima facie* claims, and that due to the regulatory system described herein, of which the Amendment is an integral part, those claims implicate important question of federal constitutional law that should be settled by this Court.

I. REVIEW IS WARRANTED TO RESOLVE A CONFLICT COCERNING WHETHER GRAND RIVER HAS ALLEGED A *PRIMA FACIE* CLAIM FOR A SHERMAN ACT VIOLATION.

The Arkansas Statute requires Grand River to comply with its provisions in one of two ways. The first option for a manufacturer whose cigarettes are sold in Arkansas is to join the MSA — an agreement that imposes a cost of doing business that has been fixed by the manufacturer's competitors, with said cost being determined annually based on the aggregate sales volume of those competitors, as well as the manufacturer's national market share relative to those competitors. The second option is to not enter into the MSA, in which case the Arkansas Statute and Amendment impose a cost burden on the manufacturer that is ultimately derived from formulas and terms set forth in the MSA. Ark. Code Ann. §§ 26-57-261.

The issue that was presented to the Eighth Circuit has previously been considered by the Second and Third Circuits, both of which held that a *prima facie* claim for relief under the Sherman Act had been pleaded. *Grand River Enterprises Six Nations, Ltd. v. Pryor*, 425 F.3d 158, 164 (2d Cir. 2005) ("*Grand River I*"); *Freedom Holdings v. Spitzer*, 357 F.3d 205, 226 (2d Cir.), *rehearing denied*, 363 F.3d 149, *on remand*, 447 F. Supp.2d 230 (S.D.N.Y. 2004); *A.D. Bedell Wholesale Co. v. Philip Morris Inc.*, 263 F.3d 239 (3d Cir. 2001).

In *Freedom Holdings*, the Second Circuit held the plaintiffs had stated a claim that the MSA structure violates the Sherman Act:

> In short, plaintiffs allege that the combination of the MSA, the Escrow Statutes, and the Contraband Statutes, allows OPMs to set supracompetitive prices that effectively cause other manufacturers either to charge similar prices or to cease selling. NPMs are forced to charge these prices to cover the costs imposed by the Escrow and Contraband Statutes or go out of business in New York.
>
> The alleged arrangement, even without the protection of the Contraband Statutes as enforced by wholesalers, would be a *per se* violation because *it is a naked restraint on competition, albeit one subject to erosion by NPMs. With the Contraband Statutes in force, the scheme as alleged threatens to become a permanent, nationwide cartel.*

> Had the executives of the major tobacco companies entered into such an arrangement without the involvement of the States and their attorneys general, those executives would long ago have had depressing conversations with their attorneys about the United States Sentencing Guidelines. We therefore hold that appellants have sufficiently alleged a *per se* violation of the Sherman Act.

Freedom Holdings, 357 F.3d at 226 (citations omitted) (emphasis added). The allegations referenced by the Second Circuit were, in substance, made in Grand River's Complaint in the Arkansas litigation.

Similarly, the Third Circuit found that the MSA structure was not immune from Sherman Act scrutiny under the state action doctrine, which was first espoused by the Supreme Court in *Parker v. Brown*, 317 U.S. 341 (1943). *A.D. Bedell*, 263 F.3d at 255-56.

The Eighth Circuit, however, affirmed the District Court's dismissal of Grand River's Sherman Act claim based upon the *Parker* state action doctrine. *Grand River II*, 574 F.3d at 939-41. Hence, the Eighth Circuit's opinion conflicts with decisions of the Second and Third Circuits, as those courts found Sherman Act claims under similar allegations.

Notably, Judge Limbaugh, a member of the Eighth Circuit Panel, in a dissenting and concurring opinion, noted his agreement with the *Freedom Holdings* and *A.D. Bedell* opinions, stating "[t]he ultimate question

then, is the degree to which the Allocable Share Amendment – the state statute – places "pressure' on plaintiffs to engage in restraint of trade in order to comply with the Amendment" and that he would afford plaintiffs the opportunity to prove the coercive effect of the Amendment. *Grand River II*, 574 F.3d at 947. Judge Limbaugh continued "[m]y concern is that the Amendment may well operate, consistent with plaintiff's allegations, *to place irresistible pressure on plaintiffs to increase their cigarette prices to match those of the OPMs and SPMs which will correspondingly reduce plaintiffs' current market share.*" *Id.* (emphasis added).

This direct conflict between the Circuits presents a substantial issue justifying Supreme Court review, particularly as the split concerns a fundamental issue concerning what constitutes a *prima facie* cause of action under the Sherman Act.

II. REVIEW IS WARRANTED TO RESOLVE A CONFLICT AS TO WHETHER GRAND RIVER'S ALLEGATIONS SET FORTH A *PRIMA FACIE* CLAIM FOR A COMMERCE CLAUSE VIOLATION

It is fundamental that a state statute or regulation violates the Commerce Clause when it directly regulates interstate commerce. *Brown-Forman Distillers Corp. v. New York State Liquor Auth.*, 476 U.S. 573, 578-79 (1986); *Edgar v. MITE Corp.*, 457 U.S. 624 (1982); *Philadelphia v. New Jersey*, 437 U.S. 617 (1978). Extraterritorial application of a state law or regulation to commerce occurring outside the state's borders is a form of direct regulation of interstate commerce that has long been prohibited. *Id.*

Grand River alleges that the Amendment, in combination with the MSA, violates the Commerce Clause, because, as recognized by the Second Circuit, Grand River's escrow obligations are tied to, and ultimately determined based on, its nationwide sales, as well as the nationwide sales of OPMs and SPMs. The effect of this system of regulation, Grand River alleges, is to control and establish uniform (higher) prices nationally.

Under a virtually identical set of allegations, the Second Circuit ruled that Grand River had alleged a Commerce Clause claim, holding "appellants have successfully stated a possible claim that the practical effect of the challenged statutes and the MSA is to control prices outside of the enacting states by tying both the SPM settlement and NPM escrow payments to national market share, which in turn affects interstate pricing decisions." *Grand River I*, 425 F.3d at 173.

Conversely, the Eighth Circuit held that the Amendment did not have an extraterritorial effect because it was not based on sales outside Arkansas and a NPM's escrow payments were entirely a function of the NPM's sales in Arkansas. *Grand River II*, 574 F.3d at 944. Judge Limbaugh again dissented, stating that "[t]he escrow obligations of NPMs under the Allocable Share Amendments are merely a component of the larger MSA scheme – a component that is designed to reign in non-MSA cigarette producers in order to perfect the goals of the MSA." *Id.* at 950. Judge Limbaugh continued "I would hold that plaintiffs have made sufficient allegations . . . to establish that the 'practical effect' of the Allocable Share Amendments (and the

MSA) is to directly regulate interstate commerce, and for that reason, plaintiffs have stated a cause of action for a Commerce Clause violation." *Id.*

The Court has consistently struck down State regulatory schemes like those identified by the Second Circuit in *Grand River* and Judge Limbaugh in the decision below, which have extraterritorial effects on pricing:

> [A] State may not adopt legislation that has the practical effect of establishing "a scale of prices for use in other states" . . . . Generally speaking, the Commerce Clause protects against inconsistent legislation arising from the projection of one state regulatory regime into the jurisdiction of another State.

Healy v. The Beer Inst., 491 U.S. 324, 336-37 (1989). State legislation that directly regulates commerce or transactions occurring wholly outside a state's borders violates the Commerce Clause *per se*, as states are only permitted to engage in "*incidental* regulation of interstate commerce . . . direct regulation is prohibited." *Edgar*, 457 U.S. at 640 (emphasis in original). Similarly, "'a state statute which by its necessary operation directly interferes with or burdens [interstate] commerce is a prohibited regulation and invalid, regardless of the purpose with which it was enacted.'" *Id.* at 642.

In *Brown-Forman*, this Court reiterated the rules that prohibit a State from directly regulating interstate commerce or commerce occurring wholly outside its

borders. 476 U.S. at 579-80 (state violates Commerce Clause when its regulation causes "producers or consumers in other States [to] surrender whatever competitive advantages they may possess"). Three years later, the Court made clear that the "practical effect" of a challenged regulation is the "critical inquiry" in determining whether it directly regulates interstate commerce and should be struck down:

> First, the Commerce Clause . . . precludes the application of a state statute to commerce that takes place wholly outside of the State's borders, . . . and, specifically, a State may not adopt legislation that has the practical effect of establishing a scale of prices for use in other States. Second, a statute that directly controls commerce occurring wholly outside the boundaries of a State exceeds the inherent limits of the enacting State's authority and is invalid regardless of whether the statute's extra-territorial reach was intended by the legislature. The critical inquiry is whether the practical effect of the regulation is to control conduct beyond the boundaries of the State. Third, the practical effect of the statute must be evaluated not only by considering the consequences of the statute itself, but also by considering how the challenged statute may interact with the legitimate regulatory regimes of other States and what effect would arise if not one, but many or every, State adopted similar legislation.

Healy, 491 U.S. at 336 (quotations and citations omitted).

The Amendment directly regulates interstate commerce under the criteria discussed in *Edgar*, *Brown-Forman* and *Healy*. A manufacturer whose cigarettes are sold in Arkansas faces two requirements under the Amendment. The manufacturer must either enter into a national settlement with *all* 46 MSA States, pursuant to which annual "settlement" payments are calculated based on its national sales volume; or, it must annually fund an escrow account for the State's benefit in an amount that is also ultimately calculated and determined based on the MSA and the amount that the manufacturer would have paid to all MSA States on account of its sales in Arkansas. *In either event, the manufacturer's liability to or for the benefit of Arkansas does not rest solely on its in-state sales but, rather, a national payment scheme that depends ultimately on national sales — demonstrating a direct, extraterritorial application of the Amendment that regulates and burdens interstate commerce.*

By requiring manufacturers to make payments to or for the benefit of Arkansas based ultimately on nationwide sales and market shares as calculated under the MSA (including in non-MSA States), the Amendment establishes, implements, and supports an interdependent and interconnecting system of regulation, the practical effect of which is to set uniform (higher) prices nationwide. *In re Beer Institute*, 849 F.2d 753, 760-61 (2d Cir. 1988) (under Connecticut statute, shipper could not, as practical matter, independently set prices in other states based on market conditions in those states, without factoring in effects those sales would have on shipper's obligations in Connecticut), *aff'd*, 491 U.S. 324 (1989) ("Court of Appeals correctly

concluded that the Connecticut statute ha[d] the undeniable effect of controlling commercial activity occurring wholly outside the boundary of the State"); *Baldwin v. G.A.F. Seelig, Inc.*, 294 U.S. 511, 521-22 (1935) (projection of legislation outside state's borders violates Commerce Clause).

In addition, Grand River has alleged that the Arkansas Statute and Amendment require Grand River – a manufacturer with no jurisdictional nexus to Arkansas – to comply with Arkansas law, based solely on the fact that Grand River's products are sold in Arkansas. Imposing regulatory payment obligations on Grand River – a Canadian corporation that does not do business in Arkansas – simply because its products are sold in Arkansas by independent third parties violates the extraterritoriality proscriptions of the Commerce Clause.

Accordingly, as the Eighth and Second Circuits have rendered diametrically opposed opinions relative to whether Grand River has alleged a *prima facie* cause of action for violation of the Commerce Clause, the Court should review this basic constitutional issue.

III. THE EIGHTH CIRCUIT'S RULING THAT GRAND RIVER'S EQUAL PROTECTION RIGHTS ARE NOT VIOLATED BY THE AMENDMENT WARRANTS REVIEW

In relevant part, the Fourteenth Amendment provides that a State may not "deny to any person within its jurisdiction the equal protection of the laws." U.S. Const., amend. XIV, § 1. Equal protection "is

essentially a direction that all persons similarly situated should be treated alike." *Cleburne v. Cleburne Living Center, Inc.*, 473 U.S. 432, 439 (1985); *Allegheny Pittsburgh Coal Co. v. Webster County*, 488 U.S. 336, 346 (1989); *Metropolitan Life Ins. Co. v. Ward*, 470 U.S. 869 (1985). Distinctions or classifications that do not burden, infringe, or differentiate based upon constitutionally protected rights survive scrutiny under the Equal Protection clause if they rationally further a legitimate State interest. *Cleburne*, 473 U.S. at 439-440. Classifications that relate to, or are based on, the exercise of constitutional rights, however, are subject to strict scrutiny. *Id.* at 440.

The Arkansas Statute and Arkansas Amendment violate these basic equal protection precepts by requiring Grand River to join the MSA (*i.e.*, become a member of a class of manufacturers defined by the MSA), but not extending to Grand River certain benefits afforded to MSA classes pursuant to the terms of the MSA, such as the exemptions afforded to Exempt SPMs that are discussed *supra*. *See Xcaliber International Limited, LLC v. Foti*, 442 F.3d 233, 235 (5th Cir. 2006). In short, there is no rational basis, and Arkansas maintains no legitimate interest, in offering or providing the foregoing reductions and exemptions to certain manufacturers but not Grand River. "When a state distributes benefits unequally, the distinctions it makes are subject to scrutiny under the Equal Protection Clause of the Fourteenth Amendment." *Hooper v. Bernalillo County*, 472 U.S. 612, 618 (1985) (State could not provide tax exemption to some veterans but not others based on whether they were resident in State during statutorily prescribed periods). *See also Williams v. Vermont*, 472 U.S. 14 (1985).

Moreover, Grand River has alleged that Arkansas and the MSA States granted the Exempt SPMs the exemptions mentioned above, as an incentive to join the MSA and relinquish their First Amendment rights. The granting of such exemptions under these circumstances makes clear that the Escrow Statute and Arkansas Amendment enjoy no deferential review, but should instead be subjected to heightened scrutiny. *See Speiser v. Randall*, 357 U.S. 513, 528-29 (1958) (where legislation affected free speech rights on discriminatory basis, burden was on State to come forth with sufficient proof to sustain regulation; State failed to show "compelling interest"); *Perry v. Los Angeles Police Dept.*, 121 F.3d 1365, 1368 (9th Cir. 1997) (State required to show legislation was "'finely tailored to serve substantial state interests'").

The Eighth Circuit determined that while the Arkansas Amendment treats NPMs differently from OPMs and SPMs, that difference was justifiable because: (1) it is rationally related to Arkansas' interest in collecting future medical costs related to tobacco use and (2) because NPMs are not parties to the MSA, they can sell their products without Arkansas interfering in their choice of advertising. *Grand River II*, 574 F.3d at 944-45.

In short, Grand River submits that the Complaint states a claim that the Arkansas Amendment denies equal protection guaranteed by both the Fourteenth Amendment, an important issue of federal constitutional law should be settled by the Court.

IV. THE EIGHTH CIRCUIT'S RULING THAT GRAND RIVER'S DUE PROCESS RIGHTS ARE NOT VIOLATED BY THE AMENDMENT WARRANTS REVIEW

No State shall deprive "any person of life, liberty or property without due process of law." U.S. Const. amend. XIV, § 1.[6]

Arkansas has no legitimate interest in mandating that Grand River enter into a settlement with 45 other States that requires Grand River to pay Arkansas (and all other MSA States) a "settlement" amount that is based on Grand River's national market share, or, alternatively, requiring Grand River to fund an escrow account for Arkansas' benefit that is ultimately based on that agreement and its payment requirements. *American Oil Co. v. Neill*, 380 U.S. 451, 458 (1965); *McCluney v. Jos. Schlitz Brewing Co.*, 649 F.2d 578, 582-83 (8th Cir. 1981), *aff'd*, 454 U.S. 1071 (1981).

Moreover, there is no rationale for Arkansas to retain Grand River's funds for twenty-five years. *See Krimstock v. Kelly*, 306 F.3d 40, 53 (2d Cir. 2002). Simply manufacturing and selling cigarettes is not, and has never been, a legal basis for holding a cigarette manufacturer liable for damages arising from the use of its product.

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6. The Escrow Statutes deprive NPMs of property. *Fuentes v. Shevin*, 407 U.S. 67, 84-85 (1972) ("it is now well settled that a temporary, nonfinal deprivation of property is nonetheless a 'deprivation' in the terms of the Fourteenth Amendment").

The Arkansas Amendment also lacks a rational relation to the purported State interest it serves. There is no proof, fact or analysis *anywhere* as to either the quantification of the claims that might be asserted by the States against Grand River or the conduct upon which the extent of that liability is to be measured. The only basis for the $4.00 per carton charge currently assessed against NPMs is that this is the amount the OPMs and Arkansas agreed to under the MSA. Accepting Grand River's allegations as true, there was no legally sufficient basis for rejecting, as a matter of law, Grand River's due process claims. In short, there is no basis for requiring Grand River to pay an amount 10,000% greater than OPMs and SPMs pay Arkansas, on account of selling an identical number of cigarettes in the State.

Finally, the Amendment provides no notice or hearing prior to the escrow payment, or any mechanism for judicial review of the lawfulness of the State's retention of the escrow payment after the seizure. The Supreme Court has "described 'the root requirement' of the Due Process Clause as being 'that an individual be given an opportunity for a hearing *before* he is deprived of any significant property interest.'" *Cleveland Bd. of Education v. Loudermill*, 470 U.S. 532, 542 (1985) (emphasis in original); *see also Xcaliber*, 442 F.3d at 235.

The Eighth Circuit held that Grand River was not denied substantive due process as Arkansas had a "legitimate interest in collecting future medical costs related to tobacco," but failed to address why Grand River should be burdened with escrow obligations even

though it had never been accused of the wrongful conduct purportedly engaged in by the OPMs. *Grand River II*, 574 F.3d at 945. With respect to procedural due process, the court found that because NPMs are paid interest on the escrow payments, the payments being supposedly linked to cigarettes sold in Arkansas and Arkansas' interest in reducing smoking related healthcare costs, procedural due process was not implicated. *Id.* at 945-46. However, the court did not address *how these factors relate to procedural due process*, or why they warrant Grand River being forced to make escrow payments without ever being afforded a hearing. *Id.*

Thus, Grand River submits that its Complaint states a claim that the Amendment violates substantive and procedural due process guaranteed by the Fourteenth Amendment, and, therefore, the Court should resolve this constitutional issue.

V. THE EIGHTH CIRCUIT'S HOLDING THAT THE AMENDMENT DOES NOT VIOLATE THE FIRST AMENDMENT WARRANTS REVIEW

As mentioned, *supra*, the MSA treats First Amendment speakers differently, by favoring the OPMs and early signing SPMs. Thus, the OPMs and, to an even greater extent, Exempt SPMs have been given a financial benefit (or "incentive") for their agreement to restrict their First Amendment rights, which is not similarly afforded to other manufacturers if they join the MSA or remain NPMs. In effect, the MSA States rewarded early signing SPMs for agreeing to the First Amendment restrictions at issue.

An NPMs' right to petition, associate, advertise and market its products free from the MSA's restrictions are undeniably guaranteed and protected rights under the First Amendment. *See, e.g., Lorillard Tobacco Co. v. Reilly*, 533 U.S. 525, 553-67 (2001) (advertising and marketing of tobacco is protected free speech); *Xcaliber*, 442 F.3d at 235. In short, Arkansas has enacted a fare for the exercise of those rights, in the form of an exemption to those who agree to limit their exercise and the denial of an exemption to those who do not, violates the First Amendment to the United States Constitution.

In a somewhat obscure passage, the Eighth Circuit ruled that Grand River was actually complaining about is the loss of a competitive advantage that existed prior to the passage of the Amendment. *Grand River II*, 574 F.3d at 946. In actuality, as discussed above, what Grand River alleges is that Arkansas has dangled rewards for those manufacturers who are willingly to bargain away their First Amendment right, and not extended those same benefits to manufacturers that elect to exercise those rights.

Yet again, Grand River respectfully submits that this important issue of constitutional law should be resolved by the Court.

CONCLUSION

For all the foregoing reasons, petitioner respectfully requests that the Supreme Court grant review of this matter.

Respectfully submitted,

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APPENDIX

APPENDIX A — OPINION OF THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT FILED AUGUST 4, 2009

UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

No. 08-1436

Grand River Enterprises Six Nations, Ltd.,

Plaintiff - Appellant,

Southwestern Trading Co., Inc.;
The Ritchie Grocer Co.,

Plaintiffs,

Heber Springs Wholesale Grocery, Inc.,

Plaintiff,

v.

Mike Beebe, in his official capacity as Attorney General, State of Arkansas,

Defendant-Appellee.

Appeal from the United States District Court for the Western District of Arkansas.

Submitted: Jan. 15, 2009
Filed: August 4, 2009

Appendix A

Before Murphy and Smith, Circuit Judges, and Limbaugh, District Judge.[1]

SMITH, Circuit Judge.

Grand River Enterprises Six Nations, Ltd., and Heber Springs Wholesale Grocery, Inc. (collectively "appellants") allege that Arkansas Code Annotated § 26-57-261 ("Allocable Share Amendment") violates the Sherman Act and various sections of the United States Constitution and the Arkansas Constitution. Mike Beebe, in his official capacity as Attorney General for the State of Arkansas ("the State"), moved to dismiss the claims for failure to state a claim upon which relief can be granted pursuant to Federal Rule of Civil Procedure 12(b)(6). The district court[2] denied the State's motion insofar as it sought dismissal of appellants' claim that retroactive application of the Allocable Share Amendment violated their due process rights.[3] All other aspects of the State's motion were granted, and appellants brought this appeal. For the following reasons, we affirm the district court.

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1. The Honorable Stephen N. Limbaugh, Jr., United States District Judge for the Eastern District of Missouri, sitting by designation.

2. The Honorable Jimm Larry Hendren, United States District Judge for the Western District of Arkansas.

3. The district court found that the retroactive application of the Allocable Share Amendment violated appellants' substantive due process rights. The State did not appeal that decision, and it is not relevant to this appeal.

Appendix A

I. *Background*

In the mid-1990s, 50 states and two territories ("settling states"), including Arkansas, filed suit against the country's major cigarette manufacturers. The action sought to recover Medicaid costs and other damages incurred by the states related to cigarette smoking and to impose restrictions on the cigarette manufacturers' sales and advertising practices. These lawsuits were settled by the execution of the Master Settlement Agreement (MSA) on November 23, 1998.

A. *Master Settlement Agreement*

The MSA was executed by the settling states and the four largest cigarette manufacturers, known as Original Participating Manufacturers (OPMs).[4] This landmark settlement agreement banned certain advertising (particularly activities targeted at youth), restricted other activities such as lobbying, and obligated the OPMs to make payments to the settling states for all future cigarette sales in perpetuity. In exchange, the settling states released pending claims and agreed to forego future claims against the OPMs related to any recovery of healthcare costs paid by the states as a result of smoking-induced illnesses.

The MSA provides for annual payments by each OPM for the benefit of the settling states. The amount

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4. The OPMs are Philip Morris, Inc., Lorillard Tobacco Company, Brown & Williamson Tobacco Corporation, and R.J. Reynolds Tobacco Company.

of each OPM's payment is based on that OPM's relative national market share. The settling states apportion the annual MSA payments among themselves according to each state's preset allocable share. Any OPM losing market share pays less to the settling states while an OPM gaining market share pays more.

Since 1998, more than 40 other tobacco manufacturers have joined the MSA and are known as Subsequent Participating Manufacturers (SPMs). SPMs and OPMs are collectively referred to as Participating Manufacturers (PMs). SPMs must also agree to abide by the MSA's restrictions in exchange for the settling states' release of present and future claims. As an incentive to join the MSA, any SPM that joined within 90 days after execution of the MSA is exempt from making annual payments to the settling states unless that SPM increases its market share beyond its 1998 levels or beyond 125 percent of its 1997 market share. An SPM joining after the 90-day period must make payments based on that SPM's national market share.

Grand River was not a party to the MSA, has not since joined the MSA, and is considered a Non-Participating Manufacturer (NPM). An NPM may become an SPM simply by joining the MSA and complying with its payment provisions. To protect the market share of all PMs, the MSA allows settling states to enact a statute which forces NPMs to place money into escrow each year to settle future judgments. An

NPM's payments into the escrow fund are dependent on the number of cigarettes that the NPM sells in that state in a given year.

B. *Escrow Statute*

The MSA is a wholly contractual agreement that requires PMs to reimburse settling states based on the national market share of their cigarette sales. But because NPMs are not parties to the contract, they are not obligated by the MSA. Therefore, the settling states may not be able to collect future judgments from NPMs for harm caused by their cigarette sales. To address this problem, the MSA allows settling states to enact statutes requiring NPMs to place money in escrow each year based on their relative market share. States may use these escrow funds to recover tobacco-related healthcare costs. Arkansas originally enacted its statute ("Escrow Statute") in 1999 and amended it in February 2005. *See* Ark.Code Ann. §§ 26-57-260, 261.

The original Escrow Statute required NPMs to deposit funds into escrow[5] that would not be released for 25 years unless a court ordered otherwise. 1999 Ark. Acts 1165. The original statute also included an exception provision to permit early release of funds. Under this provision, an NPM could obtain the release of escrow funds that were "greater than the state's allocable share of the total payments that such manufacturer would

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5. NPMs earn interest on these escrowed funds.

have been required to make in that year under the [MSA]." *Id.*

Although an NPM's escrow payments to a state were based on cigarette sales in that state, this escrow exemption provision allowed a return of the funds based on the relevant state's allocable share of the *national* MSA payments. *See id.* This provision, therefore, assumed that an NPM would sell its cigarettes nationally. Creative NPMs realized that this arrangement allowed them to concentrate their sales in a few states rather than many and thereby immediately recover most of their escrowed funds because the provision refunded escrow funds to the extent those funds exceeded each state's "allocable share" of the national MSA payment.

C. *Allocable Share Amendment*

Early escrow fund releases frustrated the purposes of the Escrow Statute. States quickly discovered the apparent hole in the statute's fabric and sought to mend it. Consequently, the Arkansas legislature amended the statute in 2005 to address this concern. Act 384 of 2005, known as the Allocable Share Amendment, amended Arkansas Code Annotated § 26-57-261(a)(2)(B)(ii) to provide in relevant part as follows:

> (B) A tobacco product manufacturer that places funds into escrow pursuant to subdivision (a)(2)(A) of this section shall receive the interest or other appreciation on

> such funds as earned. Such funds themselves shall be released from escrow only under the following circumstances:
>
> * * *
>
> (ii) To the extent that a tobacco product manufacturer establishes that the amount it was required to place into escrow on account of units sold in the state in a particular year was greater than the Master Settlement Agreement payments, as determined under section IX(i) of the Master Settlement Agreement including after final determination of all adjustments, that the manufacturer would have been required to make on account of the units sold had it been a participating manufacturer, the excess shall be released from escrow and revert back to such tobacco product manufacturer. . . .

The Allocable Share Amendment calculates escrow releases by comparing the escrow payment for an NPM's cigarettes sold in Arkansas against its hypothetical MSA payment for those same cigarettes. The original statute calculated escrow releases based on Arkansas's share of the NPM's national cigarette sales. Because of appellants' regional sales strategy, they were able to take advantage of the original escrow statute and obtain early escrow releases. After the Allocable Share Amendment was enacted, appellants' regional sales concentration lost the potential advantage

of accelerated escrow releases. Aggrieved by this statutory amendment, appellants challenged the legality of the legislative action on various federal statutory and constitutional grounds.

D. *Procedural History*

Appellants brought suit against the State to permanently enjoin enforcement of the Allocable Share Amendment. They claimed that the Allocable Share Amendment violated federal and state antitrust law; Article 2, § 19 of the Arkansas Constitution; the First Amendment of the United States Constitution; Article 2, §§ 4 and 6 of the Arkansas Constitution; the Equal Protection Clause of the Fourteenth Amendment of the United States Constitution; Article 2, § 21 of the Arkansas Constitution; and the Commerce and Supremacy Clauses of the United States Constitution.

The State filed a motion to dismiss, alleging that appellants failed to state a claim for relief and that Heber Springs Wholesale Grocery, Inc. lacked standing to sue. The district court denied the motion objecting to standing. The district court granted the State's motion to dismiss on all claims, except those relating to the alleged retroactive effect of the Allocable Share Amendment.

Concurrently with the filing of its complaint, appellants also filed a motion for preliminary injunction, seeking to enjoin the application of the Allocable Share Amendment. The district court entered an agreed order

maintaining the status quo between the parties. Given that all claims for prospective relief had been dismissed and that the status quo would remain in effect pending resolution of the issue of retroactivity, the motion for preliminary injunction was denied as moot. Grand River seeks review of the district court's order.

II. *Discussion*

We review a grant of a motion to dismiss under a de novo standard of review. *Taxi Connection v. Dakota, Minn. & E. R.R. Corp.*, 513 F.3d 823, 825 (8th Cir. 2008). We assume all factual allegations in the complaint are true. *Id.* at 826. But "the complaint must contain sufficient facts, as opposed to mere conclusions, to satisfy the legal requirements of the claim to avoid dismissal." *Id.* The motion should be granted if "it appears beyond doubt that the plaintiff can prove no set of facts which would entitle him to relief." *Id.* (internal quotation marks omitted).

A. *Sherman Act*

Appellants' complaint alleged that the Allocable Share Amendment violated state and federal antitrust law because it forces NPMs to raise their prices to prevent them from gaining a competitive advantage over PMs. The district court dismissed this claim, finding that the Allocable Share Amendment was not preempted by the Sherman Act. The district court found that because the statute did not mandate or authorize price-setting or output-fixing by private parties, it did not

violate antitrust laws. On appeal, appellants contend that because the MSA, along with the Allocable Share Amendment, confers upon PMs complete discretion through pricing decisions to drive appellants out of the market, it amounts to a cartelization of the market. Moreover, appellants assert that because the Allocable Share Amendment imposes on NPMs a parallel cost or pricing structure, it amounts to a hybrid restraint of trade and is preempted by the Sherman Act. We must determine whether an actual antitrust violation occurred, and, if so, whether immunity applies.

1. *Per Se Antitrust Analysis*

The Sherman Act provides in relevant part: "Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several states, or with foreign nations, is hereby declared to be illegal." 15 U.S.C. § 1. To violate the Sherman Act, there must be "an irreconcilable conflict between the federal and state regulatory schemes." *Rice v. Norman Williams Co.*, 458 U.S. 654, 659 (1982). A "hypothetical or potential conflict is insufficient to warrant the preemption of the state statute." *Id.* A state statute is not preempted merely "because the state scheme might have an anticompetitive effect." *Id.* It may be preempted "only if it mandates or authorizes conduct that necessarily constitutes a violation of the antitrust laws in all cases, or if it places irresistible pressure on a private party to violate the antitrust laws in order to comply with the statute." *Id.* at 661.

Appendix A

Appellants argue that they are faced with two equally anticompetitive choices: either (1) join the MSA and incur costs that are a function of and dependent upon the pricing decisions and output of appellants' competitors or (2) place a minimum amount into escrow based on the MSA, an agreement made by appellants' competitors and based on their market shares. This statutory framework, appellants allege, compels NPMs to incur a cost burden that is parallel (or identical) to that agreed to by and among competitors under the MSA.

We first inquire whether this statutory framework "is in all cases a *per se* violation" of the Sherman Act. *Id.* In *Rice*, respondents obtained a writ prohibiting the California legislature from enforcing California's liquor statutes. *Id.* at 656. The California Court of Appeals granted the writ, holding that the statute in question was *per se* illegal under the Sherman Act. *Id.* The Supreme Court reversed. *Id.* The statute required that alcohol may be brought into the state for delivery or use within the state "*only* if the beverages are consigned to a licensed importer" and provided that a licensed importer may not purchase or accept delivery of alcohol "unless he is designated as an authorized importer of such brand by the brand owner." *Id.* at 656-57. The California Court of Appeals held that this statutory scheme was a violation of the Sherman Act because it gave brand owners "unfettered power to restrain competition . . . by merely deciding who may and who may not compete." *Id.* at 658. The Court held that preemption cases require that there be an

"irreconcilable conflict between the federal and state regulatory schemes." *Id.* at 659. "The existence of a hypothetical or potential conflict is insufficient to warrant pre-emption of the state statute." *Id.* A statute would not violate the Sherman Act "simply because the state scheme might have an anticompetitive effect." *Id.* The Court found it "irrelevant" that the distiller was granted the ability to restrict intrabrand competition and that this ability had the "imprimatur of a state statute." *Id.* at 662. The Court held, therefore, that the state statute did not violate the Sherman Act. *Id.*

Here, the Allocable Share Amendment does produce "an anticompetitive effect." But this effect is insufficient to constitute an antitrust violation. *See id.* at 659. Although the statute in question places some pressure on NPMs to charge higher prices to offset the escrow payments, this pressure does not force NPMs to raise prices "in all cases." *Id.* at 661. Indeed, NPMs are free to maintain their pricing structure despite the Allocable Share Amendment. *Cf. Cal. Retail Liquor Dealers Ass'n v. Midcal Aluminum, Inc.*, 445 U.S. 97, 99-100 (1980) (holding that where the statute expressly required members of the wine industry to set price schedules for wine sales it amounted to a *per se* Sherman Act violation). The Allocable Share Amendment does not expressly allow price-fixing or output-fixing or other illegal behavior, nor does it place "irresistible pressure" on appellants to violate antitrust laws. *Rice*, 458 U.S. at 661. Therefore, the "irreconcilable conflict" required for preemption is not met. *Id.* at 659.

Appellants rely on *Freedom Holdings, Inc. v. Spitzer* for the proposition that the MSA was an "express market-sharing agreement among private tobacco manufacturers" and, therefore, the New York plaintiffs could establish Sherman Act preemption because the statute "allow[ed] OPMs to set supracompetitive prices that effectively cause[d] other manufacturers either to charge similar prices or to cease selling." 357 F.3d 205, 224, 226 (2d Cir.2004). But, on remand, the district court found that "the MSA does not 'mandate[ ] or authorize[ ] conduct that necessarily constitutes a violation of the antitrust laws in all cases, or . . . place[ ] irresistible pressure on a party to violate the antitrust laws in order to comply with the statute.' " *Freedom Holdings, Inc. v. Cuomo*, 592 F. Supp. 2d 684, 700 (S.D. N.Y. 2009) (quoting *Rice*, 458 U.S. at 661) (alterations in *Cuomo*). That court relied on updated data showing that NPMs have actually gained market share since implementation of the MSA and pay less per carton of cigarettes than PMs. *Id.* at 692.[6] The district court expressly rejected the Second Circuit's conclusion that "the MSA discourages growth and natural competition." *Id.* at 697. Relying on the aforementioned data, the district court found that "neither NPMs nor SPMs have acted as if discouraged." *Id.* The district court also cited testimony of the Chief Financial Officer of Freedom Holdings, who conceded that "their pricing decisions are made

6. Specifically, NPMs controlled 0.4 percent of the cigarette market in 1997 but now control 5.4 percent of the market. And in 2007, NPMs paid $5.02/carton while OPMs paid $5.31/carton and SPMs paid $5.07/carton. *Cuomo*, 592 F. Supp. 2d at 692.

independently and that they are not compelled to follow price leadership by their larger competitors." *Id.* at 698. The court found that the plaintiffs had not been forced or mandated to fix their prices to OPM prices. *Id.* at 699. Therefore, the district court found that no cartel existed and that the plaintiffs failed to prove their antitrust allegations. *Id.* at 700.[7]

Moreover, *Spitzer* does not satisfy *Rice*'s preemption requirements. A state statute is preempted "only if it *mandates* or *authorizes* conduct that necessarily constitutes a violation of the antitrust laws *in all cases*." *Rice*, 458 U.S. at 661 (emphasis added). The Second Circuit in *Spitzer* held only that the statute "allowed" a violation. 357 F.3d at 226. *Spitzer* did not hold that the state statute at issue mandated or authorized violative conduct in all cases. We decline to follow it.

Additionally, appellants cite *A.D. Bedell Wholesale Co., Inc. v. Philip Morris Inc.*, 263 F.3d 239 (3d Cir. 2001), in support of their preemption argument. The Third Circuit in *A.D. Bedell* held that the plaintiffs "properly pleaded an antitrust violation by alleging defendants agreed to form an output cartel." *Id.* at 249. The Third

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7. The district court in *Cuomo* noted that, in *Spitzer*, the Second Circuit "accepted Plaintiffs' allegations as if proved, for it was reviewing a motion to dismiss pursuant to Fed.R.Civ.P. 12(b)." *Cuomo*, 592 F. Supp. 2d at 700. Because the district court found that the plaintiffs failed to prove their antitrust allegations, that court stated that "the foundation for the [Second Circuit's] rulings does not exist." *Id.*

Circuit held that the states and the OPMs purposefully created a scheme that "creates powerful disincentives to increase cigarette production." *Id.* at 248. Under the MSA, PMs who increase production must increase their proportionate MSA payments. *Id.* Because lowering prices can increase market share, the increased MSA payments discourages price reductions. *Id.* To avoid gaining market share and thereby increasing proportionate MSA payments, PMs have an incentive to raise prices to match NPM's price increases. *Id.* This scheme, the court held, leads to an antitrust violation. *Id.* at 249. We disagree with the Third Circuit's conclusion that powerful disincentives are sufficient to constitute an antitrust violation under controlling Supreme Court precedent. Powerful disincentives may not produce the "irresistible pressure" which is required for an antitrust violation. *Rice*, 458 U.S. at 661, 102 S.Ct. 3294. In addition, as outlined by the district court in *Cuomo*, we note that NPMs have actually *increased* their market share since the inception of the MSA. 592 F. Supp. 2d at 692.

The Sixth Circuit's decision in *Trident International Corp. v. Kentucky*, 467 F.3d 547 (6th Cir. 2006), and the Ninth Circuit's decision in *Sanders v. Brown*, 504 F.3d 903 (9th Cir. 2007), are more persuasive. In *Trident*, the Sixth Circuit denied preemption, holding that "the facilitation, or even encouragement, of anticompetitive behavior is not sufficient to warrant federal preemption." 467 F.3d at 557. The court went on to state expressly that "in order to be preempted, [the legislation at issue] must 'mandate or authorize' illegal behavior

'in all cases.' " *Id.* (quoting *McNeilus Truck & Mfg. Co. v. Ohio*, 226 F.3d 429, 440 (6th Cir. 2000)). Likewise, in *Sanders*, the Ninth Circuit held that the statutes at issue did not "explicitly allow price fixing, market division, or other *per se* illegal monopolistic behavior." 504 F.3d at 911. It refused to find a Sherman Act violation because "[n]othing . . . forces the NPMs to either peg their prices to those of participating manufacturers, or to refrain altogether from entering the market." *Id.*

Although the Arkansas statutory framework at issue in our case may have an anticompetitive effect, it does not mandate or authorize antitrust conduct in all cases. Essentially, appellants allege that the Sherman Act is violated because they are compelled to make payments into the state's escrow fund. Although these payments may increase the cost of doing business in Arkansas, they do not amount to an antitrust injury in violation of the Sherman Act. Appellants, therefore, have not proven that the Allocable Share Amendment amounts to a *per se* violation of the Sherman Act.

2. *Hybrid Analysis*

Appellants also argue that the "parallel" cost or pricing structure created by the MSA creates a hybrid restraint of trade in violation of the Sherman Act. A "hybrid" restraint of trade is a "nonmarket mechanism [ ]" that "merely enforce[s] private marketing decisions." *Fisher v. City of Berkeley*, 475 U.S. 260, 267-68 (1986). In other words, a hybrid restraint of trade occurs when

the state passes a law that reinforces a decision by multiple companies to set a pricing scheme in violation of the Sherman Act.

The Supreme Court held that New York's liquor distribution statute was a "hybrid restraint" in *324 Liquor Corp. v. Duffy*, 479 U.S. 335, 345 n. 8 (1987). In *324 Liquor*, a New York statute required liquor retailers to charge at least 112 percent of the "posted" wholesale price for liquor. *Id.* at 337. This price was set by liquor wholesalers that are private parties. *Id.* Appellants brought suit challenging the statute under the Sherman Act. *Id.* at 340. The Court noted that "industrywide resale price maintenance . . . may facilitate cartelization." *Id.* at 341. The Court held that the New York statute was preempted because private parties set minimum prices for retailers which was then enforced by the state statute. *Id.* at 342. This statutory scheme amounted to a hybrid restraint on trade because the statute in question expressly granted authority to private actors to set prices. *Id.* at 345 n. 8.

The Allocable Share Amendment operates differently than did New York's liquor distribution statute at issue in *324 Liquor Corp.* The Allocable Share Amendment does not mandate a minimum price or cost requirement for NPMs. Moreover, PMs have not been granted any regulatory power to set prices. The Allocable Share Amendment merely sets an amount that NPMs must contribute to the state fund as a cost of doing business in Arkansas. This escrow amount is set by multiplying the number of cigarettes the NPM sells

in Arkansas by a per-cigarette amount set solely by the Arkansas legislature. This amount is not tied to PMs nor is it authorized by PMs. Therefore, the Allocable Share Amendment does not establish a hybrid restraint of trade.

3. *State Action Immunity Analysis*

The State contends that it is immune from liability under the doctrine announced in *Parker v. Brown*, 317 U.S. 341 (1943). In *Parker*, the Supreme Court held that antitrust laws were not intended to apply to states acting in their capacities as sovereigns. *Id.* at 352. To establish *Parker* immunity, the alleged restraint must be "clearly articulated and affirmatively expressed as state policy" and must be "actively supervised by the State itself." *324 Liquor Corp.*, 479 U.S. at 343.

The MSA was reviewed and approved by Arkansas's attorney general, properly enacted by the state's legislation, and duly signed by the governor. The MSA can thus be readily characterized as "state action" for *Parker* purposes. The Allocable Share Amendment was also enacted by the Arkansas legislature. As a legislative act, the amendment is not subject to the *Parker* requirements outlined in *324 Liquor*. *See Hoover v. Ronwin*, 466 U.S. 558, 568-69 (1984) (holding that "[w]here the conduct at issue is in fact that of the state legislature . . . we need not address the issues of 'clear articulation' and 'active supervision' ").

Appendix A

There are two distinct lines of cases flowing from the Supreme Court addressing *Parker* immunity. In *Midcal*, the Supreme Court held that, to invoke *Parker* immunity, the statute must be "one clearly articulated and affirmatively expressed as state policy" and must be " 'actively supervised' by the State itself." 445 U.S. at 105. Later, in *Hoover v. Ronwin*, the Supreme Court established that all State statutes automatically receive the *Parker* cloak of immunity. 466 U.S. 558, 568-69 (1984).

In *Midcal*, the Supreme Court held that to grant antitrust immunity under *Parker*, the "challenged restraint must be 'one clearly articulated and affirmatively expressed as state policy' " and "the policy must be 'actively supervised' by the State itself." *Midcal*, 445 U.S. at 105. In that case, under California's wine selling scheme, wine producers set prices and wholesalers posted a resale price schedule. *Id.* at 99. The wine prices set by a single wholesaler within a trading area bound all wholesalers in that area, and anyone selling below that level faced fines or license revocation. *Id.* at 100-01. Midcal, facing sanctions for a violation of the statute, brought a writ of mandate asking for an injunction against California's wine pricing system. *Id.* at 100. The Court held that because the statutory scheme plainly constituted resale price maintenance, it violated the Sherman Act. *Id.* at 103. The next question for the Court was to determine whether there was enough state involvement in the scheme to establish *Parker* antitrust immunity. *Id.* The Court held that more must be shown than that "anticompetitive conduct is prompted by state action;

rather, anticompetitive activities must be compelled by direction of the State acting as a sovereign." *Id.* at 104. The Court held that because California did not "actively supervise" the policy, the scheme did not have antitrust immunity. *Id.* at 105. The Court noted that California (1) "simply authorizes price setting and enforces the prices established by private parties"; (2) "neither establishes prices nor reviews the reasonableness of the price schedules"; (3) does not "regulate the terms of fair trade contracts"; (4) and does not "monitor market conditions or engage in any 'pointed reexamination' of the program." *Id.* at 105–06. The Court famously stated that "[t]he national policy in favor of competition cannot be thwarted by casting such a gauzy cloak of state involvement over what is essentially a private price-fixing arrangement." *Id.* at 106. According to the Court, "a state does not give 'immunity to those who violate the Sherman Act by authorizing them to violate it, or by declaring that their action is lawful. . . .' " *Id.* (quoting *Parker*, 317 U.S. at 351).

A few years later, in *Hoover*, the Court held that "the state action doctrine of immunity from actions under the Sherman Act" does not apply "to the grading of bar examinations by the Committee [on Examinations and Admissions] appointed by, and according to the Rules of, the Arizona Supreme Court." *Hoover*, 466 U.S. at 560. In *Hoover*, an unsuccessful candidate for the bar exam brought an action alleging that the Committee, as appointed by the Arizona Supreme Court to grade bar exams, had violated the Sherman Act by "artificially reducing the numbers of competing attorneys in the

State of Arizona." *Id.* at 564-65. The Committee alleged that they were immune from antitrust liability under *Parker*. *Id.* at 566. The Court stated that "under the Court's rationale in *Parker*, when a state legislature adopts legislation, its actions constitute those of the State, . . . and *ipso facto* are exempt from the operation of the antitrust laws." *Id.* at 567-68. A decision by the state supreme court acting legislatively rather than judicially is immune from Sherman Act liability. *Id.* at 568. Because the action at issue was carried out by a committee rather than the state supreme court itself, the Court had "to ensure that the anticompetitive conduct of the State's representative was contemplated by the State." *Id.* "[I]n cases involving the anticompetitive conduct of a nonsovereign state representative the Court has required a showing that the conduct is pursuant to a 'clearly articulated and affirmatively expressed state policy' to replace competition with regulation." *Id.* at 568-69. The Court concluded that if the action is that of the state legislature or the supreme court, then the danger of unauthorized restraint of trade does not arise and *Parker* immunity applies. *Id.* at 569. The Court held that because the Arizona Supreme Court merely delegated administration of the bar exam grading but retained final authority to grant admission to the bar, the conduct was solely that of the court. *Id.* at 572. Therefore, *Parker* immunity applied and the court was exempt from Sherman Act liability. *Id.* The Court stated that "[t]he reason that state action is immune from Sherman Act liability is not that the State has chosen to act in an anticompetitive fashion, but that the State itself has

chosen to act." *Id.* at 574. Notably, the Court stated that "[t]he action at issue here, whether anticompetitive or not, clearly was that of the Arizona Supreme Court." *Id.*

After *Hoover*, it appeared that action by a state legislature was automatically granted *Parker* immunity without reviewing the *Midcal* factors. *Hoover*, 466 U.S. at 569. But it is not clear whether *Hoover* overruled *Midcal* or whether *Midcal* exists in limited contexts. *See Sanders v. Brown*, 504 F.3d 903, 916 (9th Cir. 2007) (stating that it is "unclear whether *Hoover* and *Midcal* are coexisting 'live' precedents"). Not surprisingly, the State argues that *Midcal* is inapposite and *Hoover* controls, a conclusion that would automatically shield the state statute at issue with state action immunity. *See Hoover*, 466 U.S. at 572. Appellants advocate the *Midcal* analysis as set out by the Supreme Court in *324 Liquor*, requiring a showing that "the challenged restraint must be 'one clearly articulated and affirmatively expressed as state policy' " and that "the policy must be 'actively supervised' by the State itself." *324 Liquor*, 479 U.S. at 343.

Although we have never had occasion to follow *Hoover*, it appears to be apposite to the instant facts. The State of Arkansas entered into the MSA and legislatively enacted the Allocable Share Amendment. Thus, we hold that *Parker* "state action" immunity applies. *Parker*, 317 U.S. at 350-51.

Appendix A

B. *Commerce Clause*

Appellants next argue that the MSA violates the Commerce Clause because it requires NPMs to make payments to the State based on nationwide sales. Appellants assert that they must either enter the MSA and base their payments on national sales volume or annually fund an escrow account based on a national payment schedule. Appellants contend that this scheme violates the dormant Commerce Clause because it directly applies to commerce outside Arkansas.

The Commerce Clause grants to Congress the power "to regulate commerce . . . among the several states." U.S. Const. art. I, § 8, cl. 3. Where Congress fails to legislate on a matter concerning interstate commerce, the courts recognize "that a dormant implication of the Commerce Clause prohibits state . . . regulation . . . that discriminates against or unduly burdens interstate commerce and thereby imped[es] free private trade in the national marketplace." *R & M Oil & Supply, Inc. v. Saunders*, 307 F.3d 731, 734 (8th Cir. 2002) (internal citations and quotations omitted).

A statute may violate the dormant Commerce Clause in one of three ways: (1) the statute clearly discriminates against interstate commerce in favor of in-state commerce, *Jones v. Gale*, 470 F.3d 1261, 1267 (8th Cir. 2006); (2) it imposes a burden on interstate commerce that outweighs any benefits received, *Pike v. Bruce Church, Inc.*, 397 U.S. 137, 142 (1970); or (3) it has the

practical effect of extraterritorial control of interstate commerce, *see Healy v. Beer Inst.*, 491 U.S. 324, 336 (1989).

The district court determined that the statute did not make a distinction between interstate commerce and intrastate commerce. The district court also found that any impact on interstate commerce was incidental. But the court did not address whether the statute's burdens on interstate commerce outweighed its benefits. We will address each aspect of the dormant Commerce Clause to determine if a violation has occurred.

1. *Discrimination Against Interstate Commerce*

When considering a dormant Commerce Clause violation, we must first determine "whether the challenged law discriminates against interstate commerce." *Jones*, 470 F.3d at 1267. A state statute discriminates against interstate commerce if it accords "differential treatment of in-state and out-of-state economic interests that benefits the former and burdens the latter." *Id.*

Appellants contend that the Allocable Share Amendment directly regulates commerce occurring outside Arkansas's borders. But this argument is not persuasive. The Allocable Share Amendment does not make any distinction between in-state and out-of-state NPMs. The Amendment grants no "differential treatment" to in-state NPMs over out-of-state NPMs, thus avoiding violation of the dormant Commerce Clause.

Id.; *see also Grand River Enter. Six Nations, Ltd. v. Pryor*, 425 F.3d 158, 168-69 (2d Cir. 2005) (holding that New York's Allocable Share Amendment does not discriminate in favor of in-state manufacturers over out-of-state manufacturers).

2. *Pike Balancing Test*

State legislation is valid under the *Pike* balancing test if "the statute regulates even-handedly to effectuate a legitimate local public interest, and its effects on interstate commerce are only incidental." *Pike v. Bruce Church, Inc.*, 397 U.S. 137, 142 (1970). The statute will be upheld "unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits." *Id.*; *R & M Oil*, 307 F.3d at 735.

The intended benefit conferred to the State by the MSA and the Allocable Share Amendment is readily apparent. States negotiated the MSA with the PMs to ensure reimbursement of future medical costs incurred by a state as a result of cigarette-related healthcare expenditures. Unquestionably, the State possesses a legitimate public interest in the health of its citizens. The Allocable Share Amendment allows recovery of projected medical costs caused by cigarette smoking incident to sales by NPMs within Arkansas. NPMs pay no greater share than PMs. Any excess collected above the amount paid by PMs is returned to the NPM. Therefore, the statute regulates even-handedly to PMs and NPMs. *See Star Scientific, Inc. v. Beales*, 278 F.3d 339, 357 (4th Cir. 2002) (holding that Virginia's escrow

statute serves a legitimate and important interest). Moreover, the statute applies evenly to both in-state NPMs and out-of-state NPMs. *See Spitzer*, 357 F.3d at 219 (holding that New York's escrow statute does not impose "unequal burdens on interstate and intrastate commerce"). Because the statute is not clearly excessive in relation to the legitimate interest received, it does not violate the Commerce Clause.

3. *Extraterritorial Effect*

Appellants assert that by requiring manufacturers to make payments to Arkansas based on nationwide sales, the Allocable Share Amendment supports an interconnecting system of regulation that effectively sets uniform higher prices nationwide in violation of the Commerce Clause. This argument also lacks merit.

In *Healy*, the Supreme Court held that a Connecticut law requiring out-of-state beer shippers to affirm that the prices at which their products were sold to wholesalers were no higher than the prices at which those same products were sold in neighboring states violated the Commerce Clause. 491 U.S. at 337-38. The Court held this law violative of the Commerce Clause because it would create the "kind of competing and interlocking local economic regulation that the commerce clause was meant to preclude." *Id.* at 337. The Court considered the "price gridlock" that could occur if multiple states enacted "essentially identical" statutes. *Id.* at 339. Because the law had the practical effect of controlling liquor prices in other states and

interfered with the regulatory schemes in those states, the statute violated the Commerce Clause. *Id.* at 338-39.

Appellants rely on the Second Circuit's decision in *Grand River Enterprises Six Nations, Ltd. v. Pryor*, 425 F.3d 158 (2d Cir. 2005). In *Grand River*, the plaintiffs asserted that "the aggregate effect of the [statutes at issue] is to create a uniform system of regulation that results in higher prices nationwide." *Id.* at 171. The Second Circuit agreed, concluding that both the SPM settlement payments and the NPM escrow payments are tied to the national market share. *Id.* at 171-72. The court emphasized that the amount an NPM pays into the state's escrow fund is "keyed to the amount an NPM would have paid if it had joined the MSA as an SPM-a national-market-share-dependent amount-because the [NPM] is refunded any excess over what it would have paid under the MSA." *Id.* at 172. Therefore, the Second Circuit held that the plaintiffs "successfully stated a possible claim that the practical effect of the challenged statutes and the MSA is to control prices outside of the enacting states by tying both the SPM settlement and NPM escrow payments to national market share, which in turn affects interstate pricing decisions." *Id.* at 173. The court also stated that "we take no position as to the ultimate viability of the dormant commerce clause claim." *Id.*

But on remand the district court denied the plaintiffs' request for an injunction, finding that they were unlikely to succeed on their dormant Commerce

Clause claim. *Grand River Enters. Six Nations, Ltd. v. Pryor*, No. 02 Civ. 5068 (JFK), 2006 WL 1517603, at *9-10 (S.D.N.Y. June 1, 2006). The court stated that "[e]ven if, as the Circuit recognized, the amount of an escrow refund is, in part, keyed to the amount an NPM would have paid if it joined the MSA as an SPM—a national-market-share-dependent amount, Grand River has not shown that this scheme may result in interstate price control." *Id.* at *9 (internal quotations and citation omitted). Because the escrow statute at issue did not have any effect on cigarette prices or escrow payments by NPMs in other states, the dormant Commerce Clause was not violated. *Id.* at *9-10.

Likewise, the Allocable Share Amendment at issue here is not based on cigarette sales outside of Arkansas. NPM escrow payments are entirely a function of an NPM's sales in Arkansas. The payments are not based on nationwide sales. Nor has there been a showing by appellants that escrow payments by NPMs in Arkansas have any effect, either directly or indirectly, on cigarette prices in other states. NPMs must make escrow payments *to* Arkansas based on that NPM's cigarette sales *in* Arkansas. Arkansas has no control over cigarette prices in other states. *See Star Scientific*, 278 F.3d at 356 (holding that Virginia's escrow statute does not have the " 'practical effect' of controlling prices or transactions occurring wholly outside the boundaries of Virginia"). The MSA calculates an NPM's hypothetical MSA payment in order to refund the excess back to that NPM, but it does not allow Arkansas to control commerce in other states. *See KT & G Corp. v. Attorney*

Gen. of Okla., 535 F.3d 1114, 1144 (10th Cir. 2008) (disagreeing with the Second Circuit's decision in *Pryor*, 425 F.3d at 171-72, which found a "possible" dormant Commerce Clause violation based on the hypothetical refund). Because the statute does not affect interstate commerce, it does not violate the Commerce Clause.

C. *Equal Protection Clause*

Appellants make two arguments that the Allocable Share Amendment violates the Equal Protection Clause by favoring PMs. First, appellants contend that Arkansas does not have a legitimate interest in providing benefits to PMs that are not also granted to NPMs. Where a social or economic policy is challenged on equal protection grounds and no fundamental constitutional right has been infringed, rational basis review applies. *FCC v. Beach Commc'ns, Inc.*, 508 U.S. 307, 313 (1993); *Minn. Senior Fed'n v. United States*, 273 F.3d 805, 808 (8th Cir. 2001). The challenger must "negative every conceivable basis which might support" the legislation. *Beach Commc'ns*, 508 U.S. at 315, 113 S.Ct. 2096. Therefore, appellants have the burden of proving that the Allocable Share Statute has no rational basis.

The Allocable Share Amendment does treat PMs and NPMs differently. PMs that enter the MSA are required to deposit nonrefundable payments in perpetuity. The payments are dedicated to defraying the cost of future medical care that may be incurred by the state due to smoking-related illnesses. PMs also

must adhere to conduct limitations, such as advertising restrictions. In contrast, NPMs are not subject to the stricter conduct limitations, and their payments are only held for 25 years absent a judgment against them. This difference in treatment is rationally related to the state's legitimate interest in collecting future medical costs related to tobacco use. *See Star Scientific*, 278 F.3d at 352 (holding that NPMs essentially pay a surety bond for future liability in order to retain their ability to market as they see fit). Therefore, Arkansas's Allocable Share Amendment passes equal protection muster.

Second, Appellants argue that because the MSA exempted SPMs as an incentive to relinquish certain First Amendment rights, the statute deserves heightened scrutiny rather than the more deferential rational basis review. Appellant cites *Speiser v. Randall*, in which the Supreme Court held that where legislation affects free speech rights on a discriminatory basis, the state has the burden to show a compelling reason to sustain the legislation. 357 U.S. 513, 528-29 (1958). The granting of preferential exemptions to the SPMs for voluntarily limiting their advertising is not comparable to the legislative measures found suspect in *Speiser*. *Speiser* dealt with a California statute that denied tax exemptions to individuals unwilling to subscribe to a loyalty oath. *Id.* at 525. The statute here neither compels nor abridges free speech rights. In fact, because appellants are not parties to the MSA, they sell their products without state interference in their advertising choices. Appellants have not shown the SPM exemptions violate their right to equal protection of the law.

Appendix A

D. *Due Process Clause*

Appellants argue that they have been denied due process because (1) Arkansas has no legitimate interest in mandating that appellants enter into a settlement with 51 other jurisdictions; (2) the Allocable Share Amendment has no rational relation to the purported State interest; and (3) the Allocable Share Amendment provides no notice or hearing or any judicial review for the lawfulness of the escrow payment.

Appellants' argument includes both a substantive due process component and a procedural due process component. We must determine (1) whether appellants have a substantive due process claim; (2) whether procedural due process requires that appellants be granted a pre-deprivation hearing before the State can take appellants' escrow funds; and (3) whether appellants' available post-deprivation remedy is constitutionally sound or runs afoul of procedural due process requirements.

1. *Substantive Due Process*

Appellants summarily state that the Allocable Share Amendment has no rational relation to the purported state interest it serves. But as we held in relation to the Equal Protection Clause, the State has a legitimate interest in collecting future medical costs related to tobacco. *See supra* Part II.C. Therefore, appellants' substantive due process claim likewise fails.

2. *Procedural Due Process*

Appellants next argue that the Allocable Share Amendment violates the Due Process Clause because they are not provided notice prior to the escrow payment's imposition. Appellants emphasize that the Allocable Share Amendment contains no mechanism for judicial review. Appellants also argue that giving up funds for potentially 25 years without the benefit of a hearing is overly burdensome. Procedural due process analysis follows the standards set forth in *Mathews v. Eldridge*, 424 U.S. 319 (1976). *Eldridge* requires that we analyze the following factors: (1) private interest; (2) risk of wrongful deprivation; and (3) the government's interest. *Id.* at 335. After examining the *Eldridge* factors, we hold that Arkansas's interest in reducing smoking-related healthcare costs outweighs any private interest appellants assert.

First, appellants clearly have a private interest in any escrow payments that the statute requires them to forego for as many as 25 years. But we note that NPMs are paid interest on these payments. Second, because the escrow payments are tied directly to the number of cigarettes an NPM sells in Arkansas, there is minimal risk of wrongful deprivation. Finally, we have previously held that Arkansas has a legitimate interest in reducing smoking-related healthcare costs. On balance, these factors weigh in favor of the State's interest. Additionally, before any escrow funds are permanently retained, the State must seek and be granted a court judgment or enter into a settlement with appellants.

See Ark.Code Ann. § 26-57-261(a)(2)(B)(i). Based on these considerations, we hold that appellants' procedural due process rights have not been violated. *See KT & G Corp. v. Edmondson*, 535 F.3d 1114, 1142 (10th Cir. 2008) (denying appellants' procedural due process challenge to Kansas's and Oklahoma's allocable share amendments).

E. *First Amendment*

Finally, appellants argue that the Allocable Share Amendment violates the First Amendment. In this cursory argument, they merely assert the undisputed existence of First Amendment rights to market their wares but fail to set forth any authority or persuasive legal argument that the Allocable Share Amendment violates their First Amendment rights. It is essentially an argument that, under the Allocable Share Amendment, they do not receive something received by companies that were willing to accept the State's terms. As the district court noted, what appellants are really complaining about is the loss of the competitive advantage that previously existed before enactment of the Allocable Share Amendment under the original Escrow Statute. Loss of a competitive advantage does not equate to an unlawful burden for appellants. *See Dos Santos, S.A. v. Beebe*, 418 F. Supp. 2d 1064, 1075 (W.D. Ark. 2006) (concluding that Arkansas's Allocable Share Amendment does not unconstitutionally burden free speech).

Appendix A

III. *Conclusion*

Appellants' challenges to the Allocable Share Amendment were dismissed by the district court. After thorough review of their five arguments for reversal, we conclude that the judgment of the district court should be affirmed.

LIMBAUGH, District Judge, concurring in part and dissenting in part.

I respectfully dissent from the majority's holding that plaintiffs failed to state a cause of action on their Sherman Act claim. However, I would not reach the merits of that claim because I agree with the majority that even if plaintiffs stated a cause of action, the Attorney General of Arkansas is immune from Sherman Act liability (though not Commerce Clause liability) under the state action immunity doctrine announced in *Parker v. Brown*, 317 U.S. 34 (1943). Additionally, I respectfully dissent from that part of the majority opinion dismissing the Commerce Clause claim.

This is a difficult case, indeed, as seen by the conflicting holdings of the Circuit Courts in similar cases, and the principal opinion does an admirable job in outlining the respective positions. But all in all, I am persuaded more by the analysis in the cases that the majority acknowledges but rejects, than by the cases on which the majority relies.

A.

If I were to reach the Sherman Act claim, I would hold that the plaintiffs have stated a cause of action. The central allegations in their complaint are these:

> The Allocable Share Amendment's . . . design and purpose is to coerce Grand River and plaintiffs to raise the price of Grand River's

> cigarettes in Arkansas, thereby preventing Grand River's products from competing in the Arkansas market against Participating Manufacturers, particularly Subsequent Participating Manufacturers who have been granted payment exemptions that amount to hundreds of millions of dollars annually. The Allocable Share Amendment achieves this result by denying Grand River refunds on escrow payments that exceed the amount it would have paid Arkansas under the terms of the MSA.
>
> * * *
>
> If Grand River is deprived of its allocable share refund under the Amended Escrow Statute, its escrow costs relative to 2004 sales in Arkansas will far exceed the revenue Grand River received relative to those sales, thus placing Grand River at a financial hardship which threatens its future viability. In short, the Allocable Share Amendment effectively raises Grand River's escrow expense for 2004 by over $3,000,000,000 [presumably the amount of additional escrow expense nationwide from all states' allocable share amendments[8]]. In addition for 2005, Grand

8. Plaintiffs later alleged that "the amendment increased Grand River's escrow payment obligation in Arkansas from approximately $600,000, to over $6,000,000, for sales in 2005 alone."

> River will be forced to raise its prices, by more than $3.00 per carton, resulting in similar price increase to the remaining plaintiffs. This will result in significant loss of sales and market share for Plaintiffs and a loss of their trade relationships with retailers and distributors, particularly in comparison to grandfathered Subsequent Participating Manufactures.

The issue here, as framed by the majority, is whether the Allocable Share Amendment "places irresistible pressure on a private party [the plaintiffs herein] to violate the antitrust laws [the Sherman Act] in order to comply with the state statute [the Amendment]." This test is one of the standards under *Rice v. Norman Williams Co.*, 458 U.S. 654, 661 (1982), for determining whether there is "an irreconcilable conflict between the federal and state regulatory schemes," *id.* at 659, and whether the state statute is thus preempted, *id.* at 659-61. The Sherman Act, of course, prohibits "restraint of trade or commerce among the several states." But as the majority correctly notes, again citing Rice, "[a] state statute is not preempted merely 'because the state scheme might have an anti-competitive effect,' " and it is for that reason that the "pressure" put on private parties to become anti-competitive in order to comply with the statute must be "irresistible." The ultimate question, then, is the degree to which the Allocable Share Amendment—the state statute—places "pressure" on plaintiffs to engage in restraint of trade in order to comply with the Amendment. Although the

majority concedes that the Amendment has an anti-competitive effect, it holds as a matter of law that the pressure on plaintiffs to succumb to that anticompetitive effect is not "irresistible." I would give the plaintiffs the opportunity to prove otherwise.

My concern is that the Amendment may well operate, consistent with plaintiff's allegations, to place irresistible pressure on plaintiffs to increase their cigarette prices to match those of the OPMs and SPMs which will correspondingly reduce plaintiffs' current market share. A statutory penalty—the additional overall escrow expense caused by the reduction in refunds from their escrow payments—is imposed against them if they refuse to do so. That is an expense they allegedly cannot bear and that will soon drive them out of business.

In my view, this statutory scheme is in the nature of a so-called "hybrid" restraint of trade, another form of state law that is per se illegal under the Sherman Act. *Fisher v. City of Berkeley*, 475 U.S. 260, 267-68 (1986) As the majority notes, a hybrid restraint of trade is a "nonmarket mechanism" (a state statute, for example) that "merely enforce [s] private marketing decisions." *Id.* In this case, the apparent effect of the Amendment is to enforce a parallel pricing structure dictated by the OPMs and SPMs that will in turn fix the relative market shares between the OPMs, SPMs and the NPMs for the duration of the MSA. The scheme thus deprives NPMs of the competitive advantage they held based on their choice not to enter into the MSA and clearly

interferes with the market forces that establish cigarette prices. As such, it is illegal per se under the Sherman Act. *See Nat'l Elec. Contractors Ass'n, Inc. v. Nat'l. Constructors Ass'n*, 678 F.2d 492, 501 (4th Cir. 1982).

In short, I agree with the opinion of the 3rd Circuit in *A.D. Bedell Wholesale Co., Inc. v. Philip Morris Inc.*, 263 F.3d 239 (3rd Cir. 2001) which held that the state-by-state escrow scheme for NPMs—even before the advent of the states' allocable share amendments—was indeed an "output cartel" and thus a Sherman Act violation. *Id.* at 249-50. This, in essence, was also the holding in *Freedom Holdings, Inc. v. Spitzer*, 357 F.3d 205 (2d Cir. 2004), a case that deals directly with allocable share amendments. Although the majority, here, disparages the circuit opinion in *Spitzer* for the reason that the district court on remand found no facts to support the antitrust violation, that fact finding has no relation to the legal issue on which the circuit court based its ruling, which was that the plaintiff alleged facts sufficient to state a cause of action and thereby survive a motion to dismiss. And of course, the determination that the plaintiff failed in its proof in the *Spitzer* case is of no event because the facts in the case at hand may well be altogether different.

And finally, as I have noted, there is no need to decide the merits of the Sherman Act claim because in any event, the state of Arkansas is immune from liability.

Appendix A

B.

I would find a dormant Commerce Clause violation for essentially the same reasons that I would find a Sherman Act violation, as extrapolated to the national market. It appears to me that the operation of the MSA and its enabling statutes, in conjunction with the Allocable Share Amendment, creates a parallel pricing scheme in restraint of trade that applies not only in Arkansas, but all other states that have adopted the same or similar versions of those various statutes.

In *Healy v. The Beer Inst.*, 491 U.S. 324 (1989), the Supreme Court summarized the "cases concerning the extraterritorial effects of state economic regulation," stating:

> [A] State may not adopt legislation that has the practical effect of establishing "a scale of prices for use in other states,".... The critical inquiry is whether the practical effect of the regulation is to control conduct beyond the boundaries of the State. . . . [T]he practical effect of the statute must be evaluated not only by considering the consequences of the statute itself, but also by considering how the challenged statute may interact with the legitimate regulatory regimes of other States and what effect would arise if not one, but many or every, State adopted similar legislation. *Id.* at 336 (citations omitted).

Although the Commerce Clause violation in *Healy* was clear cut because it involved a beer-pricing scheme that expressly applied to out-of-state shippers, the *Healy* court also was concerned that,

> the practical effect of this [beer-pricing statute], in conjunction with the many other beer-pricing and affirmation laws that have been or might be enacted throughout the country, is to create just the kind of competing and interlocking local economic regulation that the Commerce Clause was meant to preclude.

Id. at 337. The court further warned against the "price gridlock" that could occur if multiple states enacted "essentially identical" statutes. *Id.* at 339-40.

Applying the *Healy* principles, the Second Circuit held that a Commerce Clause violation was properly pled in a similar Grand River case brought in New York. That case, *Grand River Enters. Six Nations, Ltd. v. Pryor*, 425 F.3d 158 (2d Cir. 2005) was accurately summarized in the majority opinion here, and that summary bears repetition:

> In *Grand River*, the plaintiffs asserted that "the aggregate effect of the [statutes at issue] is to create a uniform system of regulation that results in higher prices nationwide." *Id.* at 171. The Second Circuit agreed, concluding that both the SPM settlement

> payments and the NPM escrow payments are tied to the national market share. *Id.* at 171-72. The court emphasized that the amount an NPM pays into the state's escrow fund is "keyed to the amount an NPM would have paid if it had joined the MSA as an SPM-a national-market-share-dependent amount-because the [NPM] is refunded any excess over what it would have paid under the MSA." *Id.* at 172. Therefore, the Second Circuit held that the plaintiffs "successfully stated a possible claim that the practical effect of the challenged statutes and the MSA is to control prices outside of the enacting states by tying both the SPM settlement and NPM escrow payments to national market share, which is turn affects interstate pricing decisions." *Id.* at 173.

The Second Circuit's analysis in *Pryor* applies no less to the case at hand. Unfortunately, the majority's primary response to that analysis, like its similar treatment of the Second Circuit analysis in the *Freedom Holdings* case, is to criticize the opinion on the ground that the district court on remand found no violation. But again, the district court's fact finding has no relation to the legal issue on which the circuit court based its ruling, and the facts in the case at hand may well be different. Furthermore, the findings of the district court in *Pryor* (now *King*) are all the more insignificant because they were made pursuant to a request for preliminary injunctive relief, and in fact, the case is still in the

discovery stage, *see Grand River Enters. Six Nations, Ltd. v. King*, No. 2 Civ. 5068 (S.D.N.Y. June 16, 2009), and has not proceeded to trial on the merits.

In dismissing the Commerce Clause claim, the majority also maintains that the Allocable Share Amendment "is not based on cigarette sales outside of Arkansas," that "NPM escrow payments are entirely a function of an NPM's sales in Arkansas," and that "[t]he payments are not based on nationwide sales." All this, however, is to discount the real basis of plaintiffs' claim, which, under *Healy*, is that the MSA and its implementing statutes, in conjunction with the Allocable Share Amendments, have created an interconnecting and interdependent system of regulation in the participating states. And the practical effect of this system, they allege, is that it requires NPMs to increase their prices both in Arkansas and nationwide so to avoid increasing market share that would in turn increase their escrow costs to a level that would be impossible for them to meet. In this way, the claim is indeed based, at least in part, on cigarette sales outside of Arkansas, and the escrow payment are not entirely a function of an NPM's sales in Arkansas, but instead are based, in part, on nationwide sales. Though the majority also finds that "there has been [no] showing by appellants that escrow payments by NPMs in Arkansas have any effect, either directly or indirectly, on cigarette prices in other states," that finding ignores that the case is still in the pleading stage and that plaintiffs have not yet been given the opportunity to make such a showing.

Appendix A

In a way, plaintiffs' Commerce Clause challenge is really to the entire scheme of the MSA. The escrow obligations of NPMs under the Allocable Share Amendments are merely a small component of the larger MSA scheme—a component that is designed to reign in non-MSA cigarette producers in order to perfect the goals of the MSA. Essentially, then, plaintiffs' position is that any statute that serves to implement or enforce the MSA is no less a Commerce Clause violation than the MSA itself. Regardless, I would hold that plaintiffs have made sufficient allegations in their complaint to establish that the "practical effect" of the Allocable Share Amendments (and the MSA) is to directly regulate interstate commerce, and for that reason, plaintiffs have stated a cause of action for a Commerce Clause violation.

APPENDIX B — ORDER OF THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF ARKANSAS, FAYETTEVILLE DIVISION FILED MARCH 6, 2006

UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF ARKANSAS
FAYETTEVILLE DIVISION

Civil No. 05-5051

GRAND RIVER ENTERPRISES SIX NATIONS, LTD., and HEBER SPRINGS WHOLESALE GROCERY, INC.

PLAINTIFFS

v.

MIKE BEEBE, in his official capacity as Attorney General, State of Arkansas

DEFENDANT

ORDER

Now on this 6th day of March, 2006, comes on for consideration **Defendant's Motion To Dismiss** (document # 12), and from said motion, and the response thereto, the Court finds and orders as follows:

1. Plaintiffs seek to permanently enjoin enforcement of an Arkansas statute, A.C.A. § 26-57-261, referred to herein as the Allocable Share Amendment or the

Amendment. They claim that the Amendment violates the Sherman Act; Article 2, § 19 of the Arkansas Constitution; the First Amendment of the United States Constitution; Article 2, § 4 and § 6, of the Arkansas Constitution; the Equal Protection Clause of the Fourteenth Amendment of the United States Constitution; Article 2, § 3 and § 18 of the Arkansas Constitution; the Due Process Clause of the Fourteenth Amendment of the United States Constitution; Article 2, § 21, of the Arkansas Constitution; and the Commerce and Supremacy Clauses of the United States Constitution.

Defendant moves to dismiss these claims, taking the position that plaintiffs have failed to state claims upon which relief can be granted, and that separate plaintiff Heber Springs Wholesale Grocery, Inc., lacks standing to sue.

2. Defendant first challenges the standing of separate plaintiff Heber Springs Wholesale Grocery, Inc. ("Heber Springs") under the teachings of *Lujan v. Defenders of Wildlife*, 504 U.S. 555 (1992), under which standing requires the following:

> First, the plaintiff must have suffered an injury in fact—and invasion of a legally protected interest which is (a) concrete and particularized, and (b) actual or imminent, not conjectural or hypothetical. Second, there must be a causal connection between the injury and the conduct complained ofthe

> injury has to be fairly . . . trace[able] to the challenged action of the defendant, and not . . . th[e] result [of] the independent action of some third party not before the court. Third, it must be likely, as opposed to merely speculative, that the injury will be redressed by a favorable decision.

504 U.S. at 560-61 (internal citations and quotation marks omitted).

A review of the Complaint reflects that Heber Springs claims to be "licensed to distribute, wholesale and sell tobacco products in the State of Arkansas, including in this District," and that it "has, or intends to, engage in a substantial amount of trade and commerce in this District." (¶ 10) It is alleged that the effects of the statute herein challenged will be "a significant loss of sales and market share for Plaintiffs and a loss in their trade relationships with retailers and distributors." (¶ 38)

Although sketchy, the Court believes these allegations (fleshed out as they are by a multitude of factual allegations mainly relating to separate plaintiff Grand River Enterprises Six Nations, Ltd.) are sufficient to assert an invasion of Heber Springs' present interest in the constitutionality *vel non* of the challenged statute. These allegations suffice under *Lujan*, and the Motion To Dismiss as to Heber Springs for lack of standing will, therefore, be denied.

3. The applicable standard on a motion to dismiss for failure to state a claim is well settled:

> A complaint should not be dismissed for failure to state a claim unless it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief. A complaint must be viewed in the light most favorable to the plaintiff and should not be dismissed merely because the court doubts that a plaintiff will be able to prove all of the necessary factual allegations. Thus, as a practical matter, a dismissal under Rule 12(b)(6) is likely to be granted only in the unusual case in which a plaintiff includes allegations that show on the face of the complaint that there is some insuperable bar to relief.

Krentz v. Robertson Fire Protection District, 228 F.3d 897 (8th Cir. 2000) (internal citations and quotation marks omitted).

4. The factual allegations of the Complaint may be summarized as follows:[1]

---

1. In preparing this summary, the Court has set forth the actual text of statutes, rather than the summaries thereof contained in the Complaint, and has omitted plaintiffs' legal conclusions drawn from the facts, inasmuch as it is the function of the Court on a motion to dismiss to determine if the facts—assuming them true—would warrant the conclusions posited.

Appendix B

* Plaintiff Grand River Enterprises Six Nations, Ltd. ("Grand River") is a producer and packager of tobacco products, which does business in the State of Arkansas.

* Plaintiff Heber Springs is a distributor of tobacco products in the State of Arkansas, with its principal place of business in Heber Springs, Arkansas. It "has, or intends to, engage in a substantial amount of trade and commerce in this District."

* In 1998, Arkansas, along with 45 other states and six territories (the "Settling States"), settled litigation seeking reimbursement for medical costs associated with tobacco use. The settlement was memorialized in a document entitled the Master Settlement Agreement ("MSA"), and the settling tobacco companies are generally referred to as "Original Participating Manufacturers" or "OPMs."

* The MSA provides for annual payments by each OPM for the benefit of the *1087 Settling States. The amount of each such payment is based principally on the relative national market share of the OPM making the payment. The payments are divided among the Settling States based on a fixed formula that apportions the payment into what is referred to as each Settling State's "Allocable Share."

* The MSA imposes restrictions on the OPMs in the areas of advertising, political lobbying, trade association activities, and legal challenges to state laws

regulating tobacco, which could not have been constitutionally imposed on the OPMs without their agreement.

* After the MSA was signed, tobacco manufacturers who were not named as defendants in the litigation were offered an opportunity to sign the MSA. Those who elected to sign are referred to as "Subsequent Participating Manufacturers" or "SPMs," and the entire group of MSA signatories is referred to as "Participating Manufacturers" or PMs. Those manufacturers who elected not to sign the MSA are referred to as Nonparticipating Manufacturers or "NPMs." Grand River is an NPM.

* The Settlement was designed to reimburse the Settling States for harm caused by the PMs' wrongful conduct dating back to the 1950's; to protect PM's dominant market share by imposing similar costs on other tobacco manufacturers, whether or not they signed the MSA; and to freeze SPMs' market shares at 1997 or 1998 levels.

* The MSA contained incentives to the Settling States to enact statutes which would require NPMs (who were not subject to the payments required of PMs) to place money in escrow each year based on their market shares, such money to be held to settle or pay judgments in possible future lawsuits against them. Arkansas enacted such a law, codified at A.C.A. § 26-57-

260 and 261, and referred to as the Escrow Statute. As originally enacted, A.C.A. § 26-57-261 provided, in relevant part, as follows:

> Any tobacco product manufacturer selling cigarettes to consumers within the state ... after the date of enactment of this section, shall do one (1) of the following:
>
> (1) Become a participating manufacturer, as that term is defined in section II(jj) of the Master Settlement Agreement, and generally perform its financial obligations under the Master Settlement Agreement; or
>
> (2)(A) Place into a qualified escrow fund by April 15 of the year following the year in question the following amounts. . . .
>
> (B) A tobacco product manufacturer that places funds into escrow pursuant to subdivision (a)(2)(A) of this section shall receive the interest or other appreciation on such funds as earned. Such funds themselves shall be released from escrow only under the following circumstances:
>
> (i) To pay a judgment or settlement on any released claim brought against such tobacco product manufacturer. . . .

(ii) To the extent that a tobacco manufacturer establishes that the amount it was required to place into escrow in a particular year was greater than the State's allocable share of the total payments that such manufacturer would have been required to make in that year under the Master Settlement Agreement, as determined pursuant to section IX(i)(2) of the Master Settlement Agreement and before any of the adjustments or offsets described in section IX(i)(3) of that agreement other than the inflation adjustment, had it been a participating manufacturer, the excess shall be released from escrow and revert back to such tobacco product manufacturer.

(ii) To the extent not released from escrow under subdivisions (a)(2)(A)(i) or (a)(2)(A)(ii) of this section, funds shall be released from escrow and revert back to such tobacco product manufacturer twenty-five (25) years after the date on which they were placed into escrow.

* A.C.A. § 26-57-261(2)(B)(ii) was known as the "Allocable Share Refund" provision. It insured that an NPM would not pay more, under the Escrow Statute, than the amount Arkansas would have received from the manufacturer if it had been a PM.

* In February, 2005, the Arkansas General Assembly amended the Allocable Share Refund

provision by Act 384 of 2005. The amended provision (the "Allocable Share Amendment"), is codified at § 26-57-261(a)(2)(B)(ii), and provides as follows:

> To the extent that a tobacco product manufacturer establishes that the amount it was required to place into escrow on account of units sold in the state in a particular year was greater than the Master Settlement Agreement payments, as determined under section IX(i) of the Master Settlement Agreement including after final determination of all adjustments, that the manufacturer would have been required to make on account of the units sold had it been a participating manufacturer, the excess shall be released from escrow and revert back to such tobacco product manufacturer. . . .

* Under the Allocable Share Amendment, Grand River's escrow payments for sales in Arkansas will be greater than the amount Arkansas would have received if Grand River were a PM.

* Grand River has not been found liable for wrongful conduct, or even sued for such conduct, and there is no basis to believe that Grand River will be found liable for greater damages than the PMs during the next 25 years.

* The State of Arkansas stipulated, in state court proceedings involving the MSA, that the Escrow Statute

as originally enacted, would "effectively and fully neutralize" the cost disadvantages that PMs would experience *vis a vis* NPMs.

* The purpose of the Allocable Share Amendment is to coerce NPMs to join the MSA, thereby making non-refundable MSA payments and waiving certain First Amendment rights.

* An additional purpose of the Amendment is to cause the NPMs to raise their cigarette prices so as to prevent them from competing in the Arkansas market against PMs.

* The effect of the Allocable Share Amendment is that of an output cartel and price fixing scheme among the PMs.

* Retroactive application of the Allocable Share Amendment burdens Grand River with an additional $3,000,000.00 in escrow costs for its 2004 sales, which were not anticipated in its 2004 pricing structure. This financial hardship threatens Grand River's future viability.

* The Amendment will force Grand River to raise its prices, with a corresponding drop in sales.

* Count I alleges federal and state antitrust violations, the gist of which is that the Allocable Share Amendment is designed to force Grand River, and other NPMs, to raise their prices, so as to prevent competition with PMs.

Appendix B

* Count II alleges violations of federal and state constitutional freedom of speech and association guarantees, and more particularly that Allocable Share Amendment is designed to coerce Grand River, and other NPMs, into signing the MSA, which would require them to give up certain free speech rights.

* Count III alleges violations of federal and state constitutional guarantees of equal protection based on the classification system used in the Allocable Share Amendment.

* Count IV alleges federal and state due process violations said to arise from the "seizure" of Grand River's escrow deposits before Grand River has been found liable for wrongful conduct.

* Count V alleges violations of the Commerce and Supremacy Clauses of the United States Constitution, the gist of which is that the Allocable Share Amendment unjustifiably burdens interstate commerce and imposes a national cost on a state-wide business.

4. Defendant first contends that plaintiffs' antitrust claims are subject to dismissal. Defendant contends that the Allocable Share Amendment is a unilateral act of the State of Arkansas, and as such, is immune from antitrust scrutiny under the doctrine of state action immunity.

Plaintiffs argue that the Allocable Share Amendment creates a form of "hybrid restraint" of

competition, an exception to the state action doctrine. They summarize their antitrust claim thus: the effect of the MSA, as implemented by the Amended Allocable Share Refund provision, is to increase NPM costs, reduce pricing pressure on OPMs, and encourage PMs to reduce their output.

The Allocable Share Amendment is an act of the Arkansas Legislature, and as such, the Sherman Act issue is analyzed according to special rules that have developed over the years with regard to the antitrust effect of state statutes, and which make the acts of state sovereigns virtually immune to attack under federal antitrust provisions.

The state action immunity doctrine arose out of the case of *Parker v. Brown*, 317 U.S. 341 (1943), wherein it was decided that the Sherman Act was directed to individual rather than state action, and was not violated by state regulatory programs. It was further developed in *Rice v. Norman Williams Co.*, 458 U.S. 654 (1982), where the Court stated that

> [i]n determining whether the Sherman Act pre-empts a state statute, we apply principles similar to those which we employ in considering whether any state statute is pre-empted by a federal statute pursuant to the Supremacy Clause. As in the typical pre-emption case, the inquiry is whether there exists an irreconcilable conflict between the federal and state regulatory schemes. The

existence of a hypothetical or potential conflict is insufficient to warrant the pre-emption of the state statute. A state regulatory scheme is not pre-empted by the federal antitrust laws simply because in a hypothetical situation a private party's compliance with the statute might cause him to violate the antitrust laws. A state statute is not pre-empted by the federal antitrust laws simply because the state scheme might have an anticompetitive effect.

* * *

Our decisions in this area instruct us . . . that a state statute, when considered in the abstract, may be condemned under the antitrust laws only if it mandates or authorizes conduct that necessarily constitutes a violation of the antitrust laws in all cases, or if it places irresistible pressure on a private party to violate the antitrust laws in order to comply with the statute. Such condemnation will follow under § 1 of the Sherman Act when the conduct contemplated by the statute is in all cases a *per se* violation. If the activity addressed by the statute does not fall into that category, and therefore must be analyzed under the rule of reason, the statute cannot be condemned in the abstract. Analysis under the rule of reason requires an examination of the circumstances underlying a particular

> economic practice, and therefore does not lend itself to a conclusion that a statute is facially inconsistent with federal antitrust laws.

458 U.S. at 659-61.

In *324 Liquor Corp. v. Duffy*, 479 U.S. 335 (1987), the Court noted that it had, over time, established a two-part test for determining state action immunity under *Parker*: the challenged restraint must be "clearly articulated and affirmatively expressed as state policy," and must be "actively supervised by the state itself." 479 U.S. at 343. Yet even those requirements do not apply when the restraint under consideration is a state statute rather than the act of a subdivision of state government:

> In the years since the decision in *Parker*, the Court has had occasion in several cases to determine the scope of the state-action doctrine. It has never departed, however, from *Parker's* basic reasoning. . . . If the replacing of entirely free competition with some form of regulation or restraint was not authorized or approved by the State then the rationale of *Parker* is inapposite. As a result, in cases involving the anticompetitive conduct of a nonsovereign state representative the Court has required a showing that the conduct is pursuant to a "clearly articulated and affirmatively expressed state policy" to

> replace competition with regulation. The Court also has found the degree to which the state legislature or supreme court supervises its representative to be relevant to the inquiry. When the conduct is that of the sovereign itself, on the other hand, the danger of unauthorized restraint of trade does not arise. Where the conduct at issue is in fact that of the state legislature or supreme court, we need not address the issues of "clear articulation" and "active supervision."

Hoover v. Ronwin, 466 U.S. 558, 568-69 (1984) (internal citations omitted).

There is a limited exception to the state action immunity doctrine, explained in *Fisher v. City of Berkeley, California*, 475 U.S. 260 (1986) as follows:

> Not all restraints imposed upon private actors by government units necessarily constitute unilateral action outside the purview of § 1 [of the Sherman Act]. Certain restraints may be characterized as "hybrid," in that nonmarket mechanisms merely enforce private marketing decisions. Where private actors are thus granted "a degree of private regulatory power," the regulatory scheme may be attacked under § 1.

475 U.S. at 267-68.

Appendix B

Plaintiffs suggest that the Allocable Share Amendment comes within the purview of the hybrid restraint exception to the state action immunity doctrine. They reason that the MSA and its ancillary legislation contain such incentives for tobacco companies to increase their prices and keep their output levels the same, that it has the same effect on the market as if those companies had formed an "output cartel."

The Court does not agree with the proposition that if the potential *effect* of a statute on the market is as though private parties had created an output cartel, the statute necessarily runs afoul of the Sherman Act. It is only in very limited circumstances that such occurs. *California Retail Liquor Dealers Association v. Midcal Aluminum, Inc.*, 445 U.S. 97 (1980), illustrates the extremely narrow circumstances in which a state statute will be pre-empted by the Sherman Act. In *Midcal*, a California statute *required* liquor dealers to set prices and imposed fines on those who sold for less. The state had no direct control over the prices, and did not review the prices that were set. The Court held that the statute was pre-empted because it literally mandated price-fixing by private parties. In an oft-quoted passage, the Court stated that the "national policy in favor of competition cannot be thwarted by casting such a gauzy cloak of state involvement over what is essentially a private price-fixing arrangement." 445 U.S. at 97.

In *Midcal*, what the state did was essentially to bless private antitrust conduct and enforce violations. In the

case at bar, there is no allegation that the Allocable Share Amendment mandates or authorizes price-setting or output fixing by private parties. Instead, plaintiffs allege that the effect of the Allocable Share Amendment (in conjunction with the other statutes enacted pursuant to the MSA) is to cause or allow the PMs to conduct their business as though they were part of an output cartel. The Amendment, however, does not on its face authorize, much less require, such behavior. It simply establishes one aspect of the cost of doing business in Arkansas for those tobacco companies who have chosen not to participate in the regulatory scheme established by the MSA. Individual tobacco companies remain free to raise or lower their prices or their output as they see fit, and there is, at worst, a hypothetical or potential conflict with federal antitrust law, not the irreconcilable conflict that would be required to invalidate the Amendment under federal anti-trust law.

For the foregoing reasons, the Court concludes that plaintiffs can prove no set of facts under which the Allocable Share Amendment would be pre-empted by the Sherman Act, and the Motion To Dismiss will be granted as to that claim.

5. Defendant also contends that plaintiffs have failed to state a claim under Article 2, § 19 of the Arkansas Constitution, which prohibits monopolies. Defendant relies on *Gipson v. Morley*, 217 Ark. 560, 233 S.W.2d 79 (Ark.1950), where in it was said that

> the courts of Arkansas, like those of all American states, have sustained these

> monopolistic grants of special privilege on the ground that it is within the competency of the legislature to determine under the police power what regulatory rules are needful in controlling a type of business fraught with perils to public peace, health and safety as is the liquor business.

217 Ark. at 567.

The Emergency Clause of the Amendment makes it clear that the State of Arkansas also finds the tobacco business to be "fraught with perils to public . . . health and safety:

> [i]t is found and determined by the General Assembly of the State of Arkansas that smoking poses a serious health risk to Arkansans; that the Master Settlement Agreement is a critical component in reducing the rate of smoking in Arkansas; and that the provisions of this act are immediately necessary for the continued effective administration and enforcement of provisions of the Master Settlement Agreement in Arkansas."

Acts 2005, No. 384, § 5. This is a clear expression by the Arkansas Legislature that the regulatory scheme of which the Amendment forms a part is created to serve the public interest. Thus, to the extent that it might foster monopolistic conduct, it would not violate Article

2, § 19, of the Arkansas Constitution, and plaintiffs' claim that it would do so must be dismissed.

6. Defendant next argues that plaintiffs' freedom of speech claims must be dismissed.

The gravamen of plaintiffs' First Amendment claim is that the Act imposes penalties on Grand River, as an NPM, for refusing to waive its First Amendment rights. Fleshed out, this argument appears to be (a) that because the Allocable Share Amendment requires Grand River to pay more into its Arkansas escrow account than the amount Arkansas would receive as its allocable share of Grand River's MSA payment if Grand River were a PM, its freedom of speech (maintained by not signing the MSA) is impermissibly burdened, and (b) that it is being coerced, or at least "needlessly encouraged," to waive certain free speech rights by economic pressure to sign the MSA.

These arguments are based on the allegation that under the Allocable Share Amendment, Grand River's escrow payments for sales in Arkansas will be greater than the amount Arkansas would have received if Grand River were a PM. While this allegation must be accepted as true on a motion to dismiss, it misses the point. It is not an allegation that the regulatory scheme is so structured that it costs a tobacco manufacturer more to be an NPM than a PM. The Allocable Share Amendment does not require Grand River, or any other NPM, to pay more *per cigarette* into escrow than it

would pay *per cigarette* under the MSA if it were a PM. The relevant text of the Amendment is this:

> To the extent that a tobacco product manufacturer establishes that the amount it was required to place into escrow on account of **units sold in the state** in a particular year **was greater than the Master Settlement Agreement payments** . . . that the manufacturer would have been required to make on account of the units sold[2] had it been a participating manufacturer, the excess shall be released from escrow and revert back to such tobacco product manufacturer. . . .

§ 26-57-261(a)(2)(B)(ii) (emphasis added).

This differs from the Allocable Share Refund provision, which provided, in relevant part:

> To the extent that a tobacco manufacturer establishes that the amount it was required to place into escrow in a particular year **was greater than the State's allocable share of the total payments that such manufacturer would have been required to make in that year under the Master Settlement Agreement** . . . had it been a participating

---

2. "Units sold" is defined as "the number of individual cigarettes sold in the state by the applicable tobacco product manufacturer." A.C.A. § 26-57-260.

> manufacturer, the excess shall be released from escrow and revert back to such tobacco product manufacturer.

A.C.A. § 26-57-261(2)(B)(ii) (emphasis added).

The distinction is illustrated in an explanation of how an NPM could use the original allocable share refund (or "allocable share release") provision to its advantage, found in *Freedom Holdings, Inc. v. Spitzer*, 2004 WL 2035334 (S.D.N.Y.2004):

> In practical effect, the Allocable Share Release provision provided NPMs with substantial competitive advantages from concentrating their efforts on regional distribution. If an NPM distributed its cigarettes nationally, and its distribution patterns approximated those of the national market, its payment obligations on its national sales would be apportioned 100 percent among the settling states, with the result that something close to 100 percent of its payments would, in the aggregate, be retained under the Escrow Statute and not released under the Allocable Share Release provision. However, if an NPM were to concentrate its business to the New York—New Jersey—Connecticut area, for instance, it could gain a competitive advantage in that region, because it would make 100% of its sales there and would be able to recoup the payments on all

but roughly 16.5% of them, these being approximately the percentage shares of those states. While the OPMs and SPMs would be required to continue 100% of their payments under the MSA, an NPM which focused on the New York metropolitan area could be exempt (aside from the time-value of its money between when it was escrowed and when it was released) to the extent of over 80% of its business.

When viewed in the context of the statutes at issue, it becomes clear that what Grand River is really complaining about is the loss of the competitive advantage that could be enjoyed under the Allocable Share Refund provision. The cases cited by plaintiffs in support of their First Amendment argument will not support a claim that the loss of a competitive advantage (as opposed to the imposition of a burden not borne by other tobacco companies) unconstitutionally burdens speech, regardless of whether it is commercial or political in nature. The Court, therefore, concludes that the Motion To Dismiss should be granted as to plaintiffs' free speech claims.

7. Defendant next contends that plaintiffs have failed to state a claim that their rights to equal protection have been violated, regardless of whether that claim is analyzed pursuant to the Equal Protection Clause of the 14th Amendment to the United States Constitution, or the equal protection provisions found in Article 2, § 3 and § 18 of the Arkansas Constitution.

Appendix B

State statutes are presumptively constitutional. *Lemon v. Kurtzman*, 411 U.S. 192 (1973), citing *San Antonio Independent School District v. Rodriguez*, 411 U.S. 1 (1973). Statutes dealing with economic issues must pass only a rational basis test to survive constitutional scrutiny. The rational basis test has been articulated by the United States Supreme Court as follows:

> Under rational-basis review, where a group possesses distinguishing characteristics relevant to interests the State has the authority to implement, a State's decision to act on the basis of those differences does not give rise to a constitutional violation. Such a classification cannot run afoul of the Equal Protection Clause if there is a rational relationship between the disparity of treatment and some legitimate governmental purpose. Moreover, the State need not articulate its reasoning at the moment a particular decision is made. Rather, the burden is upon the challenging party to negative any reasonably conceivable state of facts that could provide a rational basis for the classification.

Board of Trustees of University of Alabama v. Garrett, 531 U.S. 356, 367-68 (2001) (internal citations and quotation marks omitted).

That same test has been articulated by the Arkansas Supreme Court as follows:

> There is a presumption of constitutionality attendant to every legislative enactment, and all doubt concerning it must be resolved in favor of constitutionality. If it is possible for the courts to so construe an act that it will meet the test of constitutionality, they not only may, but should and will, do so. The party challenging a statute has the burden of proving it unconstitutional.

Holland v. Willis, 293 Ark. 518, 739 S.W.2d 529 (1987).

The State of Arkansas clearly has the authority, under its police powers, to protect the health and welfare of its citizens. As evidenced by the Emergency Clause enacted with the Allocable Share Amendment, the State has found that tobacco use poses a threat to the health and welfare of those citizens, i.e., "smoking poses a serious health risk to Arkansans," and that the Allocable Share Amendment was necessary for the effective administration of the MSA, which "is a critical component in reducing the rate of smoking in Arkansas." Act 384 of 2005, § 5. These provisions of the Emergency Clause reflect a rational relationship between the Amendment and its purpose.

Plaintiffs support their equal protection argument with their allegation that the Allocable Share Amendment "will increase Grand River's net escrow

obligation under the Arkansas Escrow Statute by an amount nearly 1000% greater than the amount Arkansas would receive from Grand River if it were a Participating Manufacturer under the MSA." Even taking this allegation as true, it will not support plaintiffs' equal protection claims. It is not what *Arkansas would receive* under the MSA, but what *Grand River would pay*, that is relevant. And under the Allocable Share Amendment, Grand River cannot be required to pay more, for its Arkansas sales, than would a PM. While one figure is computed on a direct per cigarette basis, and the other is computed as a percentage of market share, that is not dispositive. As noted by the Supreme Court:

> In the area of economics and social welfare, a State does not violate the Equal Protection Clause merely because the classifications made by its laws are imperfect. If the classification has some reasonable basis, it does not offend the Constitution simply because the classification is not made with mathematical nicety or because in practice it results in some inequality. The problems of government are practical ones and may justify, if they do not require, rough accommodations—illogical, it may be, and unscientific.

U.S.R.R. Retirement Board v. Fritz, 449 U.S. 166, 175 (1980) (internal citations and quotation marks omitted).

For the foregoing reasons, the Court concludes that plaintiffs' equal protection claims must be dismissed.

8. Defendant next contends that plaintiffs have failed to state a claim for deprivation of property without due process of law. Plaintiffs, for their part, respond that the Amendment violates not only procedural but also substantive due process. The Court will examine these claims first from the perspective of the Amendment as applied prospectively, and then as to its retroactive application, commencing with the issue of substantive due process.

9. Before addressing those specific issues, it is necessary to determine whether plaintiffs have been deprived of a protected interest in liberty or property. If so, then the substance and procedure attendant upon that deprivation are examined to see if they comport with due process. *American Manufacturers Mutual Insurance Co. v. Sullivan*, 526 U.S. 40 (1999).

Defendant, while not contesting that Grand River has a property interest in the funds that must be escrowed under the Allocable Share Amendment, suggests that Grand River has not been *deprived* of that property interest, because the money paid into escrow continues to belong to Grand River unless and until the State files suit and either prevails at trial or achieves a favorable settlement of its claim. This argument runs counter to established law. "[A] temporary, nonfinal deprivation of property is nonetheless a 'deprivation' in the terms of the Fourteenth Amendment." *Fuentes v. Shevin*, 407 U.S. 67, 84-85 (1972). The Court, therefore, finds that Grand River has been deprived of an interest in property by the Allocable Share Amendment.

Appendix B

In order to pass substantive due process muster, legislation need only have a rational relationship to a legitimate state objective. The Due Process Clause "does not empower the judiciary to sit as a superlegislature to weigh the wisdom of legislation." *Exxon Corp. u Governor of Maryland*, 437 U.S. 117, 124 (1978) (internal quotation marks omitted). As explained in ¶ 7, *supra*, the Court has found a rational relationship between the Allocable Share Amendment and the State's expressed purpose of ensuring effective administration of the MSA, which is a critical component in reducing the rate of smoking in Arkansas. Thus, as to plaintiffs' claim that prospective application of the Allocable Share Amendment violates substantive due process, the Motion To Dismiss will be granted.

11. Plaintiffs contend that retroactive application of the Amendment is qualitatively different from prospective application. They point out that, in 2004—prior to the enactment of the Allocable Share Amendment, which requires a higher per-cigarette payment than did the Allocable Share Refund provision—they made their pricing decisions in light of the Allocable Share Refund provision. Thus, plaintiffs argue, the escrow deposits they have already made are inadequate under the Allocable Share Amendment and, in fact, the cost to meet the new escrow deposits required under the Allocable Share Refund provision would exceed the revenue generated by their sales during that period of time.

Appendix B

The Supreme Court has long recognized that legislation can legitimately "sweep away settled expectations suddenly and without individualized consideration," and for that reason, "retroactive statutes raise particular concerns." *Landgraf v. USI Film Products*, 511 U.S. 244, 266 (1994). In *Landgraf*, the Supreme Court listed, as being of particular concern, legislative enactments which infringe on constitutional prohibitions against *ex post facto* laws, laws which impair the obligation of contracts, laws which effect takings without just compensation, bills of attainder, and laws which deprive an affected person of due process.

> Absent a violation of one of those specific [constitutional] provisions, the potential unfairness of retroactive civil legislation is not a sufficient reason for a court to fail to give a statute its intended scope. Retroactivity provisions often serve entirely benign and legitimate purposes, whether to respond to emergencies, to correct mistakes, to prevent circumvention of a new statute in the interval immediately preceding its passage, or simply to give comprehensive effect to a new law Congress considers salutary.

511 U.S. at 267-68.

Defendant argues that the purpose of the Allocable Share Amendment is "benign," "legitimate," and "meant to 'correct mistakes' resulting from the language of the original legislation," and that since the Amendment's

intent to apply to 2004 escrow deposits is clear, there is no constitutional impediment to such application. As the Supreme Court stated in *Landgraf*, clear intent assures that the legislative body "has affirmatively considered the potential unfairness of retroactive application and determined that it is an acceptable price to pay for the countervailing benefits." 511 U.S. at 272-73.

In *Usery v. Turner Elkhorn Mining Co.*, 428 U.S. 1 (1976), the Supreme Court took up a due process challenge to a federal statute which retroactively imposed on mining companies liability for injuries caused to miners by the conditions under which they worked, even in situations where the miners had terminated their employment before the statute was enacted. The Court there noted that

> legislative Acts adjusting the burdens and benefits of economic life come to the Court with a presumption of constitutionality, and that the burden is on one complaining of a due process violation to establish that the legislature has acted in an arbitrary and irrational way. . . . [L]egislation readjusting rights and burdens is not unlawful solely because it upsets otherwise settled expectations. . . . This is true even though the effect of the legislation is to impose a new duty or liability based on past acts.

428 U.S. at 15-16.

However, as explained in the later case of *Pension Benefit Guaranty Corp. v. R.A. Gray & Co.*, 467 U.S. 717, 733 (1984),

> retroactive legislation does have to meet a burden not faced by legislation that has only future effects. It does not follow . . . that what Congress can legislate prospectively it can legislate retrospectively. The retroactive aspects of legislation, as well as the prospective aspects, must meet the test of due process, and the justifications for the latter may not suffice for the former. But that burden is met simply by showing that the retroactive application of the legislation is itself justified by a rational legislative purpose.

467 U.S. at 730 (internal citations and quotation marks omitted).

Given that "retrospective civil legislation may offend due process if it is particularly harsh and oppressive," a standard which does not differ from "the prohibition against arbitrary and irrational legislation," *Pension Benefit*, 467 U.S. at 733, the Court finds that plaintiffs have stated a claim that the retroactive application of the Allocable Share Amendment violates their constitutional right to substantive due process, and the Motion To Dismiss as to that claim will be denied.

12. The Court next examines the procedure used to effect the deprivation of property worked by the Amendment. The fundamentals of procedural due process are, of course, notice and an opportunity to be heard:

> For more than a century the central meaning of procedural due process has been clear: Parties whose rights are to be affected are entitled to be heard; and in order that they may enjoy that right they must first be notified. It is equally fundamental that the right to notice and an opportunity to be heard must be granted at a meaningful time and in a meaningful manner.

Hamdi v. Rumsfeld, 542 U.S. 507, 533 (2004) (citations and internal quotation marks omitted).

13. Plaintiffs' procedural due process challenge, as to the prospective application of the Amendment, relates to the opportunity to be heard. Does it occur at a meaningful time, and in a meaningful manner? Depending upon the circumstances, this right may be fulfilled either before or after a deprivation. In *Mathews v. Eldridge*, 424 U.S. 319 (1976), the Supreme Court took up the issue of whether-and under what circumstances-a due process hearing must be held *before* government deprives an individual of property. The Court there stated that

> identification of the specific dictates of due process generally requires consideration of

> three distinct factors: First, the private interest that will be affected by the official action; second, the risk of an erroneous deprivation of such interest through the procedures used, and the probable value, if any, of additional or substitute procedural safeguards; and finally, the Government's interest, including the function involved and the fiscal and administrative burdens that the additional or substitute procedural requirement would entail.

424 U.S. at 334-35.

The Court now examines these factors to determine whether it appears that plaintiffs could prove facts under which procedural due process would require a pre-deprivation hearing in connection with their escrow payments:

(a) The affected private interest, in this case, is the sums of money Grand River has been, and will in the future be, required to deposit into escrow and leave there for 25 years. These sums are alleged to be substantial, an allegation the Court accepts as true in connection with the Motion To Dismiss. The weight of the private interest is offset by several factors, however. The escrowed sums are no greater than the sums that OPMs are required to pay each year for the privilege of selling cigarettes, and NPMs, unlike OPMs, are not giving up ownership of their money. While the escrow deposits are not tax deductible, as are MSA payments,

Grand River and the other NPMs are compensated for the loss of use of the escrowed funds by the interest that accrues on those funds, and the escrow payment obligation is not coupled with restrictions on speech to which the PMs are subjected. In view of these facts, the Court does not find that the private interest of the NPMs weighs very heavily in the *Mathews* analysis.

(b) Although plaintiffs contend that the risk of an erroneous deprivation is substantial-they allege that the payments called for under the Amendment are not justified on the basis of any current showing of wrongful conduct on their part nor on the basis of "leveling the playing field" between NPMs and PMs—they do not dispute that their tobacco products, like any other tobacco products, have the potential to cause harm. This undisputed fact reduces the risk of erroneous deprivation to a point where procedural safeguards-in addition to those attendant upon the litigation that would be necessary before the State could deprive an NPM of ownership of its escrowed funds—would be of little benefit.

(c) The Amendment's Emergency Clause demonstrates the State's interest in this matter: reduction of smoking, which requires effective administration and enforcement of the MSA. A pre-termination hearing would entail significant burdens on this interest, as it would require premature litigation of potential claims the State might levy against plaintiffs, with the attendant risks of erroneous decision and the expenses and burdens—on both the State and the NPMs—of litigation.

Given the relatively small risk of an erroneous deprivation, the minimal value of additional procedural safeguards, and the State's unquestionable interest in the matter, the Court concludes that plaintiffs could prove no set of facts under which a pre-deprivation hearing would be constitutionally required in order for the State to implement the Allocable Share Amendment.

Although the Court concludes that a pre-deprivation hearing is not required, that finding does not completely answer the procedural due process question because, at some point, Grand River will be entitled to a hearing if it is to be deprived of ownership of its escrowed funds.

Defendant contends that the available post-deprivation remedy is constitutionally sufficient-in that Grand River will either have the right to release of the escrowed funds (after 25 years) or will have the issue resolved through litigation, with all its attendant procedural protections.

Plaintiffs disagree and insist that defendant's argument misses the point of their post-deprivation procedural due process contention: that the State can deprive an NPM of the use (although not the actual ownership) of its funds for up to 25 years without any hearing whatsoever.

It is axiomatic that for due process to exist, the right to be heard must come "at a meaningful time." *Fuentes v. Shevin*, 407 U.S. 67, 80 (1972). The Court's research has not disclosed any case in which a 25-year delay

between deprivation and remedy has been approved-or even considered. However, the Supreme Court has offered some guidance as to how to evaluate the issue.

In *U.S. v. Eight Thousand Eight Hundred and Fifty Dollars*, 461 U.S. 555 (1983), the Court took up the question of "when a post-seizure delay may become so prolonged that the dispossessed property owner has been deprived of a meaningful hearing at a meaningful time," and approved a framework for determining whether the delay in providing a post-deprivation remedy violated the due process right to be heard at a meaningful time. The Court there said that the four factors to be considered were the same as those supplied in *Barker v. Wingo*, 407 U.S. 514 (1972), to-wit:

* the length of delay;

* the reason for the delay;

* the property owner's assertion of his rights; and

* prejudice to the property owner.

In this case, as in *U.S. v. Eight Thousand Eight Hundred and Fifty Dollars*, "the overarching factor is the length of the delay." There, the Court considered a delay of some 18 months to be "quite significant," but determined it to be reasonable on the facts of the case. Here, the delay of 25 years is obviously "quite significant." However, the reason given for the delay is

also "quite significant" in the Court's view. Smoking-related health problems (and their costs) take years to appear and, thus, the State needs a "quite significant" amount of time to evaluate whether a given NPM is responsible for those costs before taking legal action. Plaintiffs do not suggest that the stated reason for the delay is false, nor do they persuasively argue that a lesser period of delay would serve the purpose equally well. Thus, the Court finds that the first two factors weigh in favor of the defendant's position.

The fourth factor, prejudice to the NPMs, also tilts in favor of the defendant. While the NPMs are deprived of the use of their escrowed funds pending the post-deprivation remedy, they are compensated for that loss by receiving interest on those funds. Meanwhile, they are able to conduct their business without restrictions on their speech. In the heavily-regulated tobacco industry, the resulting prejudice to the NPMs, on balance, is small.

The third factor, as made clear in *Barker*, is essentially a consideration of whether the property-owner acquiesces in any delay in obtaining a post-deprivation remedy. Given that plaintiffs filed the instant litigation, that factor weighs in their favor. It does not, however, outweigh the other factors in the Court's view.

After careful consideration, the Court believes that application of the *Barker* balancing test yields the conclusion that in the particular circumstances here presented, the post-deprivation remedy (either return

of the funds at the end of 25 years or litigation if the right to return is disputed) is constitutionally sufficient. "[D]ue process is flexible and calls for such procedural protections as the particular situation demands." *Cafeteria & Restaurant Workers Union, Local 473, AFL-CIO v. McElroy*, 367 U.S. 886 (1961).

14. With regard to plaintiffs' allegation that retroactive application of the Amendment violates procedural due process, the Court finds that they have stated a claim based on lack of notice. "Generally, a legislature need do nothing more than enact and publish the law, and afford the citizenry a reasonable opportunity to familiarize itself with its terms and to comply," *Texaco, Inc. v. Short*, 454 U.S. 516, 532 (1982). In this case, however, plaintiffs did not have, and could not have had, notice of the existence of the Amendment in 2004, because it had not yet been enacted. The Court finds this allegation sufficient to state a claim for deprivation of procedural due process as to the retroactive application of the Amendment.

15. *Commerce Clause Claim*-Defendant next contends that plaintiffs have failed to state a claim under the Commerce Clause of the United States Constitution.

The constitutional principles involved have been summarized by the Supreme Court as follows:

> Our Constitution was framed upon the theory that the peoples of the several states must sink or swim together. Thus, this Court has

> consistently held that the Constitution's express grant to Congress of the power to regulate Commerce . . . among the several States contains a further, negative command, known as the dormant Commerce Clause, that creates an area of trade free from interference by the States. This negative command prevents a State from jeopardizing the welfare of the Nation as a whole by plac[ing] burdens on the flow of commerce across its borders that commerce wholly within those borders would not bear. Thus, we have found unconstitutional state regulations that unjustifiably discriminate on their face against out-of-state entities, or that impose burdens on interstate trade that are clearly excessive in relation to the putative local benefits. We have held that States may not impose taxes that facially discriminate against interstate business and offer commercial advantage to local enterprises, that improperly apportion state assessments on transactions with out-of-state components, or that have the inevitable effect [of] threaten[ing] the free movement of commerce by placing a financial barrier around the State.

American Trucking Associations, Inc. v. Michigan Public Service Commission, 545 U.S. 429 (2005) (internal citations and quotation marks omitted). The Supreme Court has also held that "[i]n evaluating state regulatory measures under the dormant Commerce

Clause . . . the first step . . . is to determine whether it regulates evenhandedly with only incidental effects on interstate commerce, or discriminates against interstate commerce." *Fulton Corp. v. Faulkner*, 516 U.S. 325 (1996) (citations and internal quotation marks omitted).

The Allocable Share Amendment, on its face, makes no distinction between interstate and intrastate transactions, acting even-handedly on all NPMs regardless of where they are situated. To the extent that it has any impact whatsoever on interstate commerce, that impact is indirect and incidental. The State's interest in regulating tobacco manufacturers is a legitimate one under its police powers, with significant local benefits, as expressed by the Emergency Clause. Nothing in plaintiffs' Complaint, or in their brief on the issue, indicates that they can prove up a set of facts under which any indirect impact on interstate commerce would exceed that State interest. The Motion To Dismiss plaintiffs' Commerce Clause claim will, therefore, be granted.

16. Finally, defendant claims that plaintiffs have failed to state a claim under the Supremacy Clause of the United States Constitution. Plaintiffs make no response to this argument, and the Court finds that it is conceded. The Motion To Dismiss will, therefore, be granted as to plaintiffs' Supremacy Clause claims.

IT IS THEREFORE ORDERED that **Defendant's Motion To Dismiss** (document # 12) is **granted in part and denied in part.**

Appendix B

The motion is **denied** insofar as it seeks dismissal of plaintiffs' claims that retroactive application of A.C.A. § 26-57-260-261, as amended by Act 384 of 2005, to plaintiff Grand River Enterprises Six Nations, Ltd.'s, 2004 escrow deposits violates substantive and procedural due process.

The motion is **granted** in all other respects.

IT IS SO ORDERED.

/s/ Jimm Larry Hendren
JIMM LARRY HENDREN
UNITED STATES DISTRICT JUDGE

APPENDIX C – ORDER OF THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT DENYING PETITION FOR REHEARING DATED AND FILED OCTOBER 1, 2009

UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

No. 08-1436

Grand River Enterprises Six Nations, LTD,

Appellant

Southwestern Trading Co., INC. and
The Ritchie Grocer Co.,

v.

Mike Beebe, in his official capacity as
Attorney General, State of Arkansas,

Appellee

Appeal from U.S. District Court for the
Western District of Alabama - Fayetteville
(5:05-cv-05051-JLH)

ORDER

The petition for rehearing en banc is denied. The petition for rehearing by the panel is also denied.

Appendix C

Judge Shepard did not participate in the consideration or decision of this matter.

October 01, 2009

Order Entered at the Direction of the Court:
Clerk, U.S. Court of Appeals, Eighth Circuit.

/s/ Michael E. Gans

APPENDIX D — RELEVANT STATUTE

Arkansas Code Annotated § 26-57-261

(a) Any tobacco product manufacturer selling cigarettes to consumers within the state, whether directly or through a distributor, retailer, or similar intermediary or intermediaries, after the date of enactment of this section and § 26-47-260, shall do one (1) of the following:

(1) Become a participating manufacturer, as that term is defined in section II(jj) of the Master Settlement Agreement, and generally perform its financial obligations under the Master Settlement Agreement; or

(2)(A) Place into a qualified escrow fund by April 15 of the year following the year in question the following amounts, as such amounts are adjusted for inflation:

(i) 1999: $.0094241 per unit sold after the date of enactment of this section and *§ 26-57-260*;

(ii) 2000: $.0104712 per unit sold;

(iii) For each of 2001 and 2002: $.0136125 per unit sold;

(iv) For each of 2003 through 2006: $.0167539 per unit sold; and

(v) For each of 2007 and each year thereafter: $.0188482 per unit sold.

(B) A tobacco product manufacturer that places funds into escrow pursuant to subdivision (a)(2)(A) of this section shall receive the interest or other appreciation on such funds as earned. Such funds themselves shall be released from escrow only under the following circumstances:

(i) To pay a judgment or settlement on any released claim brought against such tobacco product manufacturer by the state or any releasing party located or residing in the state. Funds shall be released from escrow under subdivision (a)(2)(B)(i) of this section:

(a) In the order in which they were placed into escrow; and

(b) Only to the extent and at the time necessary to make payments required under such judgment or settlement;

(ii) To the extent that a tobacco product manufacturer establishes that the amount it was required to place into escrow on account of units sold in the state in a particular year was greater than the Master Settlement Agreement payments, as determined under section IX(i) of the Master Settlement Agreement including after final determination of all adjustments, that the manufacturer would have been required to make on account of the units sold had it been a participating manufacturer, the excess shall be

released from escrow and revert back to such tobacco product manufacturer; or

(iii) To the extent not released from escrow under subdivisions (a)(2)(B)(i) or (a)(2)(B)(ii) of this section, funds shall be released from escrow and revert back to such tobacco product manufacturer twenty-five (25) years after the date on which they were placed into escrow.

(C) Each tobacco product manufacturer who elects to place funds into escrow pursuant to subdivision (a)(2) of this section shall annually certify to the Attorney General that the tobacco product manufacturer is in compliance with subdivision (a)(2) of this section. The Attorney General may bring a civil action on behalf of the state against any tobacco product manufacturer who fails to place into escrow the funds required under this section. Any tobacco product manufacturer who fails in any year to place into escrow the funds required under this section shall:

(i) Be required within fifteen (15) days to place such funds into escrow as shall bring him or her into compliance with this section. The court, upon a finding of a violation of subdivision (a)(2) of this section, may impose a civil penalty to be paid to the general fund of the state in an amount not to exceed five percent (5%) of the amount improperly withheld from escrow per day of the violation and

in a total amount not to exceed one hundred percent (100%) of the original amount improperly withheld from escrow;

(ii) In the case of a knowing violation, be required within fifteen (15) days to place such funds into escrow as shall bring him or her into compliance with this section. The court, upon a finding of a knowing violation of subdivision (a)(2) of this section, may impose a civil penalty to be paid to the general fund of the state in an amount not to exceed fifteen percent (15%) of the amount improperly withheld from escrow per day of the violation and in a total amount not to exceed three hundred percent (300%) of the original amount improperly withheld from escrow; and

(iii) In the case of a second knowing violation, be prohibited from selling cigarettes to consumers within the state, whether directly or through a distributor, retailer, or similar intermediary for a period not to exceed two (2) years.

(b) Each failure to make an annual deposit required under this section shall constitute a separate violation.